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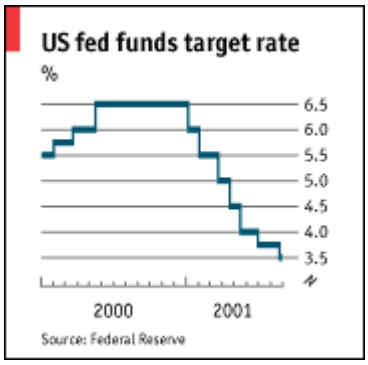
Business this week

Aug 23rd 2001
From The Economist print edition

America cuts again



As had been widely expected, America's Federal Reserve **cut interest rates** by a quarter of a percentage point to 3.5%, the lowest level since 1994. The Fed cited falling profits and investment in American businesses, and weakening demand for exports. It also suggested that the next move would probably be another cut. America's trade deficit in goods and services grew to $29.4 billion in June, almost $1 billion up on May; both imports and exports declined as the world economy sputtered.

See article: Get a parachute

After 11 days of talks, the IMF announced that it would offer **Argentina** a new loan of $8 billion, of which $3 billion is to support a “voluntary and market-based” debt restructuring. Argentina's government promised a new law reforming provincial finance. Prices of Argentine bonds and shares rose, but credit-rating agencies said the deal was not enough to persuade them to upgrade Argentine debt.

See article: Too little, too late?

Industrial production in the **euro area** rose in June by 0.6%, making an increase of 1.4% over the previous 12 months. However, production contracted in both the first and second quarters and the outlook appears gloomy. Inflation fell to 2.8% in the year to July, strengthening the chances that the European Central Bank will cut interest rates when it meets next week.

A WTO report lambasted an American system of **tax breaks** to exporters worth some $4 billion. The foreign sales corporation scheme was changed last year after complaints by the EU but is still in breach of WTO rules. If America does not appeal against the findings before a mid-October deadline, the EU has promised retaliatory sanctions that could spark a full-scale trade war.

In the latest move in a long-running dispute, **Canada** said it would ask the World Trade Organisation to rule against a decision earlier this month by the United States to slap tariffs of at least 19.3% on imports of Canadian lumber.

Computer error

Poor results at **Hewlett-Packard** led to rumours that Carly Fiorina, the computer giant's glamorous chief executive of the past two years, might go. But HP's board expressed its “100% support” for Ms Fiorina and her efforts to restructure the company. She showed no sign of shifting.

Fujitsu, a struggling Japanese chip maker, announced a restructuring in the face of collapsing chip prices around the world. Around 16,400 jobs will go, nearly 10% of the total workforce.

Shares in **Excite@home**, an American Internet service provider and media company, suffered a fall of 46% as rumours spread that the company would declare itself bankrupt.

Tempus omnia revelat

WPP, the world's biggest advertising agency, trumped last month's bid by **Havas**, a French rival, for **Tempus**, a British media-buying company in which it already owns a 22% stake. The British agency's bid values the company at around £437m ($631m); Havas is mulling whether to improve its offer. WPP and Havas both released results for the first half that showed some growth despite a dramatic downturn in the advertising industry.

See article: Monkey puzzle

Deutsche Post, Germany's part-privatised postal service, announced that operating profit for the first half was up 5.5% compared with a year ago, to *euro*1.4 billion ($1.26 billion). The main contributor was old-fashioned mail delivery. The German government recently agreed to extend the company's postal monopoly until 2007.

Novartis, a giant Swiss pharmaceutical company, received the welcome news that its “blockbuster” cancer drug, Zometa, had been approved by America's Food and Drug Administration.

Credit Suisse First Boston, an investment bank that has had its fair share of regulatory difficulties of late, appointed Gary Lynch as its senior legal officer. Mr Lynch once led the enforcement division of America's Security and Exchange Commission, bringing to book both Ivan Boesky and Michael Milken.

Nomura Research Institute, a subsidiary of Nomura Group, Japan's biggest securities firm, announced that it would attempt to raise ¥24 billion ($200m) through an initial public offering, despite the fact that Japan's stockmarket is at a 17-year low.

Two American insurance companies, **AIG** and **W.L. Ross**, are to pay $860m for stakes in three financial affiliates of South Korea's Hyundai Group. This is the biggest foreign investment in the South Korean financial industry.

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Politics this week

Aug 23rd 2001
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Bombs in Spain

In San Sebastian, in Spain's **Basque region**, a small bomb hidden in a toy car badly wounded an infant and killed his grandmother. Not an ETA bomb, said those terrorists' friends. Few believed them. In towns nearby, police later seized weapons, 160kg of explosives and the real car intended to carry it.

AP

Having sent an advance guard, NATO decided to push on with its full arms-collecting mission in **Macedonia**, despite many breaches of the supposed ceasefire.

See article: How many groups, how many guns?

After talking to Joschka Fischer, the German foreign minister, who was trying to mediate in the **Middle East** peace process, Yasser Arafat, the Palestinian leader, and Shimon Peres, Israel's foreign minister, said they were ready to meet, perhaps in Berlin. No date was set. Five Palestinians were shot dead by Israeli soldiers in Nablus, and a car bomb exploded in Jerusalem. The European monitoring force in Hebron announced that it was ending its patrols because of increased violence.

Settling scores

Within days of last week's murder of François Santoni, a prominent **Corsican nationalist**, an associate of his was found murdered, with another man. A further settling of intra-nationalist accounts?

EPA

Although a cabinet decision is yet to come, Italy's prime minister, Silvio Berlusconi, indicated that Italy would stick to its earlier intention of getting November's **FAO summit** meeting shifted from Rome, probably to an African city. A meeting of NATO defence ministers in September will be moved from Naples itself to a nearby military base.

As **Britain's Conservative Party** squabbled over the election of a new leader, Margaret Thatcher denounced Europhile Kenneth Clarke and backed Europhobic Iain Duncan Smith. Others queued up to denounce Lady Thatcher.

AP

See article: Death Wish 2

Poland's main political parties signed an agreement to co-operate, whoever won the election of September 23rd, in its effort to gain membership of the European Union.

Cabinet maker

In **Iran**, the reformist majority in Parliament ratified President Muhammad Khatami's nominations to his

new cabinet, despite earlier threats to reject them.

See article: Shuffling the pack

After widespread condemnation of their arrests, 75 Christian and anti-Syrian activists were released from prison in **Lebanon**.

See article: Divide and rule

The Great Helmsman departs

AP

Senator Jesse Helms, conservative scourge of the United Nations, Fidel Castro, the International Criminal Court, the anti-smoking lobby and many other things, announced that he would retire from the Senate in 2003, rather than seek a sixth term.

See article: Should he be missed?

As work was due to commence to clear the ground for an eventual missile-defence testing site in Alaska, America insisted it would withdraw from the **ABM treaty** unilaterally if necessary. Russia announced it was willing to make “certain amendments” to the treaty.

A federal judge in America rejected environmentalists' pleas for protection for a dwindling population (around 350) of **Beluga whales** in the Cook Inlet in Alaska.

Colombia's public prosecutor formally charged three suspected members of the IRA with training the FARC guerrillas and carrying false passports. Meanwhile, the country's Supreme Court approved an American request for the extradition of three drug traffickers. One of them, Fabio Ochoa, was an associate of the late Pablo Escobar, a notorious Medellin trafficker.

Trying Cambodia's past

Cambodia confirmed that Khieu Samphan will stand trial in connection with atrocities carried out during the **Khmer Rouge** regime of 1975-79. Mr Khieu Samphan, who was president of the regime, denies that he was involved and maintains that Pol Pot was in charge. Pol Pot died in 1998.

In the **Philippines'** worst fire for five years, more than 70 people died in a Manila hotel. Investigators said the emergency exits were locked.

Sri Lanka's separatist **Tamil Tigers** stepped up their attacks in the 18-year-old civil war, killing 15 people in a police station and blowing up a bus, injuring 15 passengers. The government put the capital, Colombo, on alert for further attacks.

Police in **Bangladesh** said that all the country's jails were full after 58,000 people suspected of criminal activity had been arrested ahead of a general election due in October.

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World economy

Get a parachute

Aug 23rd 2001
From The Economist print edition

The world economy may be in a recession already

Ronald Grant

FOR the seventh time this year, America's Federal Reserve has cut interest rates, this time by a quarter-point to 3.5%, leaving the federal-funds rate a full three percentage points lower than at the start of 2001. Americans hope that Alan Greenspan, the Fed's chairman, is doing enough to prevent a recession. But for some it is too late. The sharp slowdown in America has already caused a recession, maybe not at home, but in Mexico, Singapore, Taiwan and elsewhere. In more and more countries around the world output is now stalling, if not falling. Total world output probably fell in the second quarter for the first time in two decades (see article).

America's GDP growth in the second quarter is widely expected to be revised down next week to zero or even negative, and although there are signs that the economy may be close to a trough there is little sign of a rebound. Meanwhile, the news from around the rest of the world is getting gloomier. In the second quarter, Germany's economy stagnated, and growth in the euro area as a whole was probably not much above zero; Japan's economy saw a steep decline; and many economies in East Asia and Latin America are slumping alarmingly.

The current global slowdown differs from others in the past half-century in three ways that may determine its outcome. The most striking is that economic weakness is more widespread than in previous downturns. In the 1991 “world recession”, for instance, the American economy sank, but Japan, Germany and emerging East Asia continued to boom, helping to cushion world demand. So far this downturn is not deep, but it could be the most synchronised since the 1930s.

Therein lies the biggest risk. Economies have become increasingly integrated through trade and investment in recent years, to their great benefit. But the downside to this globalisation is that the economic slowdown around the world is now proving self-reinforcing, magnifying the initial fall in demand. As investment has collapsed in America and Japan, those countries have slashed their imports from East Asian producers. But weaker demand in Asian countries is causing them in turn to trim their imports, not just from America and Japan, but also from Europe. The chances of a prolonged American (and global) downturn have thereby increased considerably.

The second big difference has, at least superficially, more positive implications. In contrast to previous world recessions in the past three decades, inflation is low. This means that there is plenty of room to ease monetary policy. Furthermore, America entered this downturn with a large budget surplus, for the first time since the 1970s. That surplus has made possible the tax cuts which—with lucky timing—are now going out to households and may yet help to prop up consumer spending. The scope for monetary and fiscal easing offers one reason to hope that America can avoid a deep recession.

The snag is that the money-transmission mechanism, through which interest-rate cuts affect the economy, seems to be partly blocked. There is always a lag of 6-12 months before monetary policy has its main impact, but it traditionally works through lower long-term bond yields, higher share prices and a weaker dollar. Yet since the Fed started to cut interest rates, long-term rates have fallen only slightly, share prices have declined and the dollar, despite its recent drop, is still stronger than it was at the start of the year. The awkward truth is that monetary conditions have hardly eased.

Where interest-rate cuts have helped to sustain demand is through the housing market. House prices in

America are rising at their fastest pace for more than a decade. This has cushioned consumer wealth from the fall in share prices and encouraged households to refinance mortgages, allowing them to keep up their spending. But how long can house prices remain buoyant if company layoffs continue at their current pace? If house prices crumble, so surely will consumers.

At least the Fed is doing everything it can to prevent a recession. Sadly, the same is not true of policymakers in the euro area and Japan. The European Central Bank has cut interest rates only once this year, to 4.5%. Falling inflation and a strengthening euro mean that it no longer has any excuse: the ECB should cut rates again at its meeting on August 30th. Another problem is fiscal policy, as slower growth is swelling governments' budget deficits. This is right and proper during a downturn, but it risks pushing deficits above the ceiling laid down in Europe's “stability pact”. The pact should be scrapped (see article).

Japan, too, risks exacerbating its deflationary slump if the government goes ahead with its plan to cut public spending. Budget cuts can wait until the economy perks up. The Bank of Japan, on the other hand, needs to act now to halt deflation, by pursuing a far more aggressive monetary easing. Sadly, since 1990 it has offered a useful lesson to other central banks around the world on how not to handle the bursting of an investment bubble.

Vicious cycle

The third way in which this downturn may differ from previous ones is that it has not been caused by a collapse in demand after central banks have raised interest rates to fight inflation. Instead, it is an investment-led downturn. America's long expansion in the 1990s encouraged rosy expectations about future growth and profits, encouraging over-investment financed by heavy borrowing. When there is excess capacity and an overhang of debt, interest-rate cuts tend to be less effective in reviving demand. Investment-led recessions, which were common before the second world war, tend to be deeper and to last longer because it takes longer to purge financial excesses and over-capacity than it does to tame inflation.

Worries that America's downturn may be more protracted than originally expected are largely to blame for the recent slide in the dollar. Some commentators are even calling for policymakers to push the dollar lower to help America's shaky economy. A modest further fall in the dollar against the euro alone might be beneficial. It would support American demand and, by helping to reduce inflation in the euro area, also make it easier for the ECB to cut interest rates.

However, a plunge in the dollar against all the main currencies would be dangerous. To the extent that a sharp fall in the dollar reflected fading faith in America's economic prospects it would further undermine confidence and knock share prices, which could weaken consumer spending. A free-falling dollar would also make America's huge current-account deficit harder to finance, and might thereby limit the Fed's room to cut interest rates again. Meanwhile, an abrupt rise in the euro and the yen would squeeze their economies, as America exported its recession. Japan desperately needs a weaker, not a stronger yen. With interest rates in Japan already at zero, the exchange rate is one of the few channels through which monetary easing can still work.

No investment bubble has ever burst without causing a serious economic downturn. Even if America avoids an outright recession, its slowdown is likely to be prolonged. The crude manipulation of exchange rates cannot prevent global recession. Instead, and until economies look rosier, central banks should keep easing monetary policy and governments should be more flexible over their fiscal policies—and all should keep their fingers firmly crossed.

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The IMF and Argentina

Too little, too late?

Aug 23rd 2001
From The Economist print edition

A new loan does not guarantee deliverance from recession

Get article background

PAUL O'NEILL, America's folksy treasury secretary, explained why the talks between Argentina and the IMF over a new loan dragged on into a second week. “We're working to find a way to create a sustainable Argentina, not just one that continues to consume the money of plumbers and carpenters who make $50,000 a year and wonder what in the world we're doing with their money,” he told American television viewers. In fact, Argentina has not defaulted on past loans from the IMF, so that unless the plumbers and carpenters have been dabbling in emerging-market bonds, their money is still unconsumed. Even so, Mr O'Neill's aim is a noble one. It provides a useful test for judging this week's agreement, under which the IMF will offer Argentina a new loan of $8 billion.

The loan is needed because of fears that Argentina might be pushed to default on its debts or devalue its currency. For months such fears have cast a pall of gloom over South America, and over emerging markets in general. It is argued that a financial meltdown in Argentina, which enthusiastically pursued free-market policies in the 1990s, would not only place neighbouring Brazil in jeopardy but deliver a setback to the cause of liberal reform in Latin America as a whole.

So will the new loan achieve its goals? Certainly, it should buy Argentina's government some time: $5 billion of the new money can be used straightaway. By reassuring Argentines that the government has the funds to back the country's currency-board arrangement, which pegs the peso at par to the dollar, it should halt a recent run on bank deposits.

The agreement's chief aim is to tame Argentina's debt burden. It includes one novel element: $3 billion of the money is intended to back a “voluntary and market-based” restructuring of Argentina's public debt. And to stop the debt growing, the loan is tied to the strict implementation of an austere fiscal policy, approved by Argentina's Congress last month, whose aim is to balance the budget. In particular, the IMF wants new legislation to reform (read “cut”) the finances of provincial governments (see article).

None of this will be easy, especially since a congressional election is due in mid-October, in which President Fernando de la Rua's weak government is unlikely to be strengthened. What is more, while a large-scale debt restructuring is necessary, it will be complicated. The details remain sketchy. But the money involved looks to be too little to help Argentina to meet some $17 billion in debt-service payments due next year.

Prolonging the agony

A “sustainable Argentina” can only be one whose economy starts to grow again, after a crunching recession which has now lasted three years. Sadly, on this crucial point, the new agreement is unconvincing. It does not address the rigidity of Argentina's economic policies.

The currency board worked well in vanquishing inflation. But the peg to the mighty dollar has made Argentina a cripplingly expensive country in which to do business, especially since Brazil's currency has devalued by 52% against the dollar since January 1999. Under the currency board, Argentina also forswears an independent monetary policy: interest rates depend, not on its central bank, but on the mood of investors. To cap that, fiscal policy is now aggravating the recession: successive austerity

packages have led only to falling tax revenues, requiring further spending cuts.

It is true that the currency board makes a devaluation especially difficult and costly (around 70% of bank deposits and private-sector debt is in foreign currency). But the existing policies are inimical to growth—unless a continued fall in the value of the dollar fortuitously comes to Argentina's rescue.

The IMF's bet is that fiscal austerity and debt restructuring will restore investors' confidence in Argentina, allowing interest rates to fall sharply. But achieving such a sea-change in investor sentiment requires banishing, rather than merely postponing, all fears of a debt default and devaluation. This would take a far larger loan, combined with an unequivocal message that the United States will not let Argentina fail.

Mr O'Neill has criticised the Clinton administration's past support for large bail-outs of emerging economies, believing that this outcome proved too charitable to private investors. The danger is that he has backed an unsatisfactory stopgap, a dripfeed that will only prolong Argentina's financial agony. Because it is too small to transform investor sentiment, but also leaves in place policies which seem unable to deliver growth, the IMF agreement has not passed the test of creating a “sustainable” Argentina. Those plumbers and carpenters had better watch their wallets.

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Europe's single-currency rules

Scrap the stability pact

Aug 23rd 2001
From The Economist print edition

Constraints on Europe's fiscal policies could seriously damage its economic health

AP

THOSE who invent monstrous chopping machines, from Procrustes to Dr Guillotin, have a nice way of subsequently falling victim to them. It was thus divinely fitting that Hans Eichel, Germany's finance minister, should be one of the first to grumble publicly about Europe's "stability and growth pact", whose fiscal limits Germany may soon run up against. For the monstrous stability pact was designed and imposed, against the reservations of other putative single-currency members, by the previous German government, back in 1996.

Mr Eichel has since renounced his apostasy, sworn fealty to the doctrine of budget discipline and promised not to seek any changes to the stability pact (see article). More's the pity. For, as he initially suggested, the automatic chopping that can be required by the stability pact could do serious harm in an economic downturn—of precisely the kind that now looms.

The stability pact sets legally binding ceilings of 3% of GDP on euro-zone countries' budget deficits. The penalty for a breach is payment of a non-interest-bearing deposit that can be converted into a fine as large as 0.5% of GDP. There is a let-out clause in the event of recession, but it is far too tightly drawn, applying only if GDP falls by a minimum of 0.75%. Had the pact been in operation over the past 15 years, both France and Germany would have been liable to pay fines on at least three occasions apiece.

Why does such a seemingly barmy pact exist? The German fear was that, without it, every euro member would have an incentive to run a big deficit, since the cost in higher interest rates and greater default risk would be shared collectively. Fiscal discipline was needed to get into the euro, but was even more urgent afterwards if the markets were to have confidence in the currency.

These arguments are entirely bogus. If a euro member borrows more, the impact on other countries' interest rates is minimal. So long as there is no chance of a bail-out by the centre—and the rules of Europe's monetary union specifically rule this out—default risk will remain with the borrower and be reflected in its bond yields. And, though markets generally like fiscal discipline, larger budget deficits are more forgiveable than having the wrong fiscal stance for the circumstances.

That is a particular danger now, as the euro area faces the possibility of its first recession. The single currency has deprived its members of any independent control over monetary policy or the exchange rate, so the burden of any necessary response to a recession falls more on fiscal policy. Yet the European Commission has declared that, in Italy, Germany and France, the stability pact must not only preclude any fiscal easing but even trammel the operation of fiscal "automatic stabilisers". That could mean that these countries are required to raise taxes or cut public spending even as their economies slow. That smacks of 1930s-style self-flagellation.

Mr Eichel hinted that the stability pact should apply to levels of spending, not to budget deficits. The Belgians, Italians and others have suggested that the pact should be revised so that it applies to cyclically adjusted deficits, to allow more automatically for the effects of booms and busts. But since the stability pact serves no positive purpose, and risks doing such serious harm, it would be far better and cleaner simply to get rid of it altogether.

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America and India

The price of friendship

Aug 23rd 2001
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Time to lift post-nuclear sanctions on India?

Reuters

IT WAS a puzzle of the cold war that the world's most powerful democracy and its biggest managed to rub along so badly. Just when the United States and India were at last warming to each other, India's nuclear-bomb tests three years ago, provoking counter-blasts from Pakistan and blowing a hole through the global anti-proliferation effort, brought on a new chill. Bill Clinton's trip to India last year broke the ice. Now George Bush is pressing to lift what remains of the sanctions that Congress imposed on both India and Pakistan after their tests. Some officials even muse privately about nuclear contacts with India, despite the global rules that ban nuclear help for and trade with countries that, like India and Pakistan, refuse to sign the Nuclear Non-Proliferation Treaty or else reject full international safeguards on their nuclear industry. But scrapping sanctions on India has its costs.

Without doubt both America and India could benefit from better relations. India has no intention of putting itself in any big power's pocket. But after decades of over-dependence on Russia for diplomatic and military support, hob-nobbing with America can help India broaden its horizons and balance the growing regional weight of China. For its part America, enjoying merely the illusion of a unipolar moment in what is an increasingly multi-polar world, has interests in Asia—not least of them steadying the now nuclear-tipped rivalry between India and Pakistan, and managing the rise of China—where easier relations with India could help. India's economic reforms, though slow and halting, open up new trading prospects, too.

Part of the case for lifting post-test sanctions is that they have not worked. India and Pakistan were told sternly they must cap and roll-back their nuclear programmes, sign the Comprehensive Test-Ban Treaty (CTBT) and end production of bomb-making material. India dug its heels in and Mr Clinton soon whittled his demands down to a cap on nuclear activities and signature of the CTBT; without winning either, he eased some sanctions and waived others. Those that remain ban sales of military equipment, restrict trade in items that have potential military uses with a (dwindling) group of companies with nuclear connections, and block some loans. They hurt Pakistan most, though they still irritate India.

But mostly the Bush team wants to scrap the sanctions because it has different goals. Though Mr Bush has said he has no plans to test, he refuses to ratify the CTBT, and will not press India even to sign it. This is a mistake, since America's security would suffer as much as anyone's if the anti-testing norm erodes and others scramble to build fancier bombs. American officials these days stress only the need for India and Pakistan to learn to live safely with their bombs. That dismays those who worry that, by letting both get away with their nuclear nose-thumbing, America is inviting others to try. But the administration's rush to lift sanctions may also deprive it of leverage in pursuit of its modest goal.

Still living dangerously

Before abandoning all sanctions, as India wants, America should surely be pressing both governments to accept confidence-building measures to deal with nuclear accidents or prevent miscalculation in a crisis. They have none. Instead, India and Pakistan are engaged in a dangerous race to build ever longer-range missiles—of the sort that America is trying to counter in other parts of the world with its expensive plans for missile defences. To mitigate the nuclear dangers, India needs to give a clearer promise not to test again, a pledge not to deploy nuclear-tipped missiles and a firm commitment not to export nuclear or

missile technology. So does Pakistan.

As for helping India or Pakistan with nuclear power or to build safer nuclear warheads, that would break long-standing anti-proliferation promises to the rest of the world. It could be done only at everyone's peril, America's included.

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Welfare reform

A lesson for the world

Aug 23rd 2001
From The Economist print edition

Praise for a legacy of Bill Clinton that has really worked

Get article background

SEVEN years ago, the cover of *The Economist* had a picture of a wretched looking black teenager cuddling a baby in what looked like a third-world shanty town but turned out to be Chicago ("Welfare's children", June 18th 1994). It marked Bill Clinton's first attempt to "end welfare as we know it"—to change a system that seemed to breed dependency for poor parents and their children. Eventually, on August 22nd 1996, a welfare-reform bill was agreed with the Republican Congress. It stopped welfare being an entitlement. Poor mothers—women and their children make up 90% of those on welfare—would have to look for work, and, even if they did so, they would no longer just get federal money on demand. Instead the states were given a limited, set amount of money ($16.5 billion) to dispense as they saw fit, with the onus being on spending money on work programmes rather than handouts. States receive bonuses for moving people into work.

The bill was derided as cruel and racist by many Democrats. Even supporters thought that it was underfunded. In fact it has succeeded beyond even its boosters' aims (see article). The number of welfare recipients has fallen from 12.2m in 1996 to 5.8m last June. Young mothers who have never married are now more likely to be working than on welfare. Income figures have improved a little (though the increase in people's wages has been offset by a decline in benefits). More poor parents are married—something which sharply increases the chances of their children growing up healthily and safely. Teenage pregnancy rates have fallen. And so on.

There are still a few ifs and buts. Yes, the encouraging figures were helped by America's economic success, and the true test of reform may come with the downturn; but the core of achievement has been to do with policy. Yes, there are plenty of other things helping rekindle the nuclear family; but welfare reform has at least been a prompt. Yes, to support marriage is controversial. But by most standards, the American government still penalises marriage—particularly for poor people. If a single working mother on the minimum wage marries a man earning $8 an hour, she loses $8,060 in benefits.

In short, the chances are that the wretched woman on our cover in 1994 now has better prospects. For this, she has to thank two unlikely bedfellows: Newt Gingrich, whose Republican radicals actually wanted to extend the block-grant system of set federal payments to other social programmes; and Mr Clinton, the first Democrat to push for radical reform.

Challenges for America—and for Europe

Next year Congress has to reauthorise the 1996 bill (which it should do at at least the same level of funding). It should also tidy up the food-stamps programme, get rid of the marriage penalty for the poor and expand the earned-income tax credit for the working poor. More broadly, America's welfare problem may have eased, but its poverty problem remains. The poor's schools are often rotten, and they are still subject to the menace of the drug war. One in six American children lives in poverty, almost double the ratio for big European countries.

The danger of complacency for Europeans is precisely the opposite: that America's generally carefree treatment of poor people will blind them to a success that can be copied. So far, only Britain has looked

to America for inspiration, with some success. Continental European countries have tended to shudder about the morality of forcing people to work. As well as the cost of entitlement, they should consider the morality of keeping people on benefit. As Franklin Roosevelt, the patron saint of the welfare state, once said, “continued dependence on relief induces a spiritual and moral disintegration.”

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Letters

Aug 23rd 2001
From The Economist print edition

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Legalising drugs

SIR – You are right to point out in your survey of illegal drugs (July 28th) that production and traffic began in response to a demand from prosperous developed countries. The business is so profitable and attractive that people from all walks of life in both rich and poor countries actively take part in it, notwithstanding the serious threats and risks involved. You correct an unfair version that traditionally placed full responsibility for this problem on the underdeveloped countries where many of these drugs originate.

Unfortunately, for the countries and societies that are currently most affected by the dreary implications of this problem, the prolonged battle against illicit-drug production, trafficking and related crimes has not yet delivered the expected results. The reasons have to be sought in the lack of real and decisive co-ordination of the actions that have to be carried out by all the parties involved.

The solution lies in applying the principle of shared responsibility. Even though several formal agreements are in place, we are still expecting action and results on all fronts. The effectiveness of current policy worldwide depends heavily on the decisive implementation, in developed nations, of controls on the laundering of illegal incomes and the diversion of chemical precursors employed in illegal-drug production, as well as the sale of weapons in underdeveloped countries that are acquired by drug-trafficking networks to protect investments and interest by violent means.

It will be absolutely impossible for Colombia to attain peace and give to its citizens the benefits of the economic, social and political reforms that are currently under discussion until society as a whole is able to control, reduce and then eradicate this illegal business.

Roberto Arenas Bonilla
Colombian ambassador
Brussels

SIR – A change in global drugs policies might be affected more readily by the governments of producing, not consuming, nations. Legalising and taxing coca production, for example—irrespective of the legal status of its consumption abroad—would provide badly needed revenue to the state and personal income to the individual, and might well stabilise the domestic politics of those nations.

David Shohan
New York

SIR – John Stuart Mill's harm principle makes a fine case for a laisser-faire approach to government, but I doubt that he would endorse drug legalisation. In his book “Utilitarianism”, he writes that people:

> do give a most marked preference to the manner of existence which employs their higher faculties. Few human creatures would consent to be changed into any of the lower animals, for a promise of the fullest allowance of a beast's pleasures; no intelligent human being would consent to be a fool, no instructed person would be an ignoramus, no person of feeling and conscience would be selfish and base, even though they should be persuaded that the fool, the dunce, or the rascal is better satisfied with his lot than they are with theirs.

Mill suggests there is something intrinsically important about having full control over one's faculties. Drugs certainly reduce that control.

Kenneth Shevlin
New Haven, Connecticut

SIR – As one who has handled adverse drug reactions for the past ten years for a major pharmaceutical company and who has just co-authored a text on this subject, I would like to note that we are probably underestimating the non-lethal adverse reactions due to illicit drugs. Deaths due to illegal drugs are dramatic and, to a large degree, calculable. It is a binary question—dead or not dead. Non-fatal reactions that are difficult to discern and require medical testing (abnormal liver or kidney function, raised blood pressure, etc) often go unnoticed and under-reported. Even with the formal systems in place in most of the developed world, it is difficult to quantify adverse events associated with marketed pharmaceuticals. Hence, one should be careful before ascribing benignity or relative harmlessness to certain illicit drugs, particularly “soft drugs”.

Barton Cobert
Westfield, New Jersey

SIR – You ignore the impact on organised (or otherwise) crime once its principal source of revenue is cut short through legalisation. The repeal of prohibition in America turned organised crime's focus from booze to drugs. What horrid venture will crime turn to once drugs are legalised?

Rob Ellaway
Vancouver

SIR – Your criticism of America's ill-advised “war on drugs” is on target. During my 17 years with the New York Police Department and 18 years as police chief of Kansas City, Missouri, and San Jose, California, I found that mandatory drug sentences do not lessen drug use, but they do destroy families and neighbourhoods, and push drug users into lives as career criminals. In America, police resources now used to make over 700,000 marijuana arrests a year would be better spent to pursue those attacking women and children. Police drug-war tactics are the father of police racial profiling. There are many costs of this country's unsuccessful war on drugs, but future historians will view this period of greatly disproportionate incarceration of minorities for drug crimes as a blot on honour similar to the acceptance of slavery. It does not take a bloody civil war as a remedy, merely some legislative common sense and compassion.

Joseph McNamara
Stanford University
California

SIR – You mention that hemp was an economic threat to Mellon and DuPont. There is another explanation for the rise of the marijuana laws. Marijuana was originally outlawed in 1915 in south-western America because of racial prejudice against the Mexican immigrants who smoked it. In the north-eastern states marijuana was outlawed largely because of fears that heroin addiction would lead to the use of marijuana (the opposite of what the prohibitionists tell us today).

There is not a lot of evidence to support the Anslinger-Hearst-DuPont-Mellon theory. There is no direct evidence that they thought hemp was enough of an economic threat to do anything about it. Indeed, historical information would indicate otherwise. The best evidence is a report to Anslinger by a field agent on the 1934-35 hemp crop in Minnesota. The sum of the report is that several farmers tried to grow hemp and were generally unsuccessful.

There is no apparent evidence of a conspiracy in the congressional hearings on the subject. In fact, representatives of the hemp industry testified that if it was necessary to protect the country they were willing to stop its cultivation. Only the American Medical Association and the birdseed industry opposed the law. The AMA said that there was no evidence that marijuana was dangerous and the birdseed people said canaries would not sing without it.

Clifford Schaffer
Director DRC Net Online Library of Drug Policy
Canyon Country, California

SIR – You neglect the difficulty of designing and implementing effective drug control short of prohibition; a difficulty illustrated by current failures with alcohol, nicotine and gambling. The problem might be solved for cannabis by allowing production and possession for personal use while preventing commercialisation. This might eliminate many of the costs of prohibition while increasing the abuse of cannabis only modestly. By contrast, legalising commerce would create an industry with the capacity and incentive to produce addiction; responsible, low-volume, low-frequency use is by its very nature also low-revenue.

For heroin, cocaine and methamphetamine the rates of addiction among users are too high and the destructiveness of addiction too great to make regulation workable. Any scheme of taxation and regulation that did not leave the drugs so cheap and so available as to increase hugely the abuse problem would instead generate an illicit market not much smaller than exists under prohibition. At worst, a licit market in any of these drugs could just create new addicts for the illicit market to supply. Making prohibition work better, rather than ending it, has the best prospects for minimising the total social damage from drugs and drug controls.

Mark Kleiman
Director Drug Policy Project Federation of American Scientists
Washington, DC

SIR – One of the largest crime problems in America is with stolen legal drugs on the black market. There is also the problem of forged prescriptions, doctors who sell drugs and parents who sell their children's prescriptions. The only reason this problem is not larger is that many people turn to illegal drugs. You also perpetuate the myth that drugs only hurt the person taking them. Obviously you have not seen the effects on a newborn infant of his mother's cocaine addiction.

You state that if drugs were legalised, availability could be regulated between children and adults. Currently children illegally obtain prescription drugs, alcohol and cigarettes, all of which are regulated. You state that health warnings could be given. We are giving those from school onwards, but not with the mixed message you suggest: if you do get addicted the government will give you more. And can we control a person's craving for drugs by giving them what they need? I asked a heroin addict, “How much dope do you use a day?” The answer: “All I can get.” If you lower the cost of drugs people will not spend less money, they will just buy more drugs.

Joseph Cassilly
State's attorney for Harford County
Bel Air, Maryland

SIR – An inexpensive and effective solution to the drug problem has been implemented in Singapore: the death penalty. Singapore has none of the collateral damage and social costs associated with drug abuse. If nations are unwilling to use measures of that sort, then legalisation is the only option that makes much sense. All intermediate measures are costly, ineffective, and socially destructive.

Brian Lynch
Austin, Texas

SIR – You mention Americans' ignorance of the metric system “back in 1986”. Americans today are just as ignorant of the metric system as they were 15 years ago—except pot-smokers. They all know that a quarter ounce is seven grams.

James Sebrell Farmer
Seattle

Russell's nuclear reaction

SIR – I certainly do not concede that Bertrand Russell advocated “an early pre-emptive strike against the Soviet Union”, as Lord Lawson claims (Letters, August 18th). What he advocated was a continuation of the West's policy of containment from a position of strength. In answer to a question as to what would happen in the event that the policy failed, Russell said that a war before Russia had nuclear weapons would be less disastrous than one after she had them—he did not infer from this that a war should be started straightaway. The policy of containment was, of course, backed by the threat of war, but Russell's clarity of thought (which Lord Lawson praises) enabled him to see that this was quite different from advocating a pre-emptive strike.

Lord Lawson may have been present when Russell spoke but I have a verbatim transcript of what he said.

Nicholas Griffin
McMaster University
Hamilton, Canada

Gore the extremist

SIR – It seems the Democratic Leadership Council (DLC) is not looking at the whole picture when it concludes that social issues damaged Al Gore's presidential run ("More questions than answers", July 21st). Mr Gore's message of class warfare was a turnoff for voters like me and my husband. It was only because we were certain what George Bush would do about issues important to us (gun control and the environment) that we voted Democratic. Had the Republicans run a moderate candidate, Mr Gore's defeat would have been decisive. The DLC needs to consider the votes Mr Gore won, as well as the ones he lost.

Beth Martin
Grosse Pointe Farms, Michigan

Japan's war memorial

SIR – Junichiro Koizumi's visit to the Yasukuni war shrine has reinforced the persistent fear of the revival of Japanese militarism ("Shrine wars", August 11th). The late George Taylor, an eminent scholar of Asia, fittingly characterised Japan's behaviour in the second world war: "They don't rule, they occupy, they do not tax, they expropriate, they do not compromise, they terrorise, they do not respect native culture, they ram their own mystical rubbish down the throat of people far more civilised than themselves." It is doubly troubling that some western nations still view the latent militaristic government as an ally to fend off a cold-war enemy that longer exists.

P. Lee
Hong Kong

SIR – While many condemn the visit by Mr Koizumi to the Yasukuni shrine a few points are worth keeping in mind. While atrocities were indeed committed by Japan in the course of its occupation of neighbouring countries, they are almost benign in comparison to the fratricidal murderousness which followed. Korea needed no help from Japan to split itself up and create arguably the most repressive regime the world has ever seen. Under Mao, China witnessed more deaths through starvation and sheer ignorance than in the second world war.

Judging the actions of the past is little more than posturing unless done so within the context of the time. Japan had modelled its society on the West after all. That includes empire building. The brutal betrayal and occupation of the Philippines by America occurred at roughly the same time as Japan's occupation of Korea, yet it would be the height of presumption to demand an equivalent act from America. You say that there are only a dozen objectionable persons included there. Is it really fair to ignore the countless others because of opposition from a few small domestic groups, and some very hypocritical overseas ones?

Jude Kirkham
Vancouver

Non-speaker Rostenkowski

SIR – You say that Dan Rostenkowski was "the once all-powerful speaker of the House [of Representatives]" (Lexington, August 4th) He never held that post. He was, in fact, the chairman of the Ways and Means Committee of that body, the committee charged constitutionally with originating all revenue-raising measures.

Benjamin Ira Gertz
New York

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The world economy

A global game of dominoes

Aug 23rd 2001
From The Economist print edition

The world economy is probably already in recession. How bad might it get?

ONE by one, economies around the world are stumbling. By cutting interest rates again this week—for the seventh time this year—the Federal Reserve hopes it can keep America out of recession. But in an increasing number of economies, from Japan and Taiwan to Mexico and Brazil, GDP is already shrinking. Global industrial production fell at an annual rate of 6% in the first half of 2001.

The picture may soon look even worse. Early estimates suggest that gross world product, as a whole, may have contracted in the second quarter, for possibly the first time in two decades. Welcome to the first global recession of the 21st century.

So far, America itself has escaped a technical recession, defined as two quarters of falling GDP. But on August 29th revised figures are expected to show that America's GDP growth in the second quarter was close to zero or even negative, rather than the 0.7% annual rate originally announced. With GDP growing well below trend for several quarters, profits tumbling and unemployment rising, it now smells horribly like a recession.

As yet there is no sign of a V-shaped bounce-back in America

America's index of leading economic indicators has risen for four consecutive months, suggesting that the worst may be over. But as yet there is no sign of the V-shaped bounce-back in the economy that most economists had promised earlier this year. The 32% fall in new orders for electronic goods in the year to June signals that capital spending will plunge further as firms respond to weak profits and excess capacity. The Fed's “beige book”, a monthly survey of economic activity, suggests that the manufacturing slump is now spreading to the rest of the economy.

So far, the consumer has kept the American economy ticking along—partly thanks to rising house prices, which have cushioned household wealth against the drop in share prices. But retail sales were flat in both June and July, down from an annual growth rate of 10% in early 2000; and consumer credit fell in June. Many commentators argue that America can still avoid recession, so long as consumer spending does not collapse. But 1982 suggests otherwise: America then had its deepest recession since the 1930s, yet consumer spending continued to grow, offset by plunging investment and exports.

Consumer spending may soon perk up as tax-rebate cheques drop through letterboxes. But worries about jobs could lead workers to save the money instead. The jobless rate has risen by 0.6 percentage points since last October, and recently announced huge layoffs imply that it will rise further. Goldman Sachs forecasts a rate of 5.2% in 2002, up from 3.9% last year. Unemployment has never previously

risen by this much without there being a recession.

Nowhere is safe

Earlier this year, when America first sneezed, the European Central Bank (along with most private-sector economists) argued that the euro area was insulated from America's slowdown and had little to worry about. This seems to have been wrong. In Germany there are fears about recession as business investment and retail sales tumble. The blame lies with weaker domestic spending rather than exports. New figures this week confirmed that Germany's GDP stagnated in the second quarter. But the Ifo survey of business confidence was better than expected in July, rising for the first time this year.

Italy's GDP fell in the second quarter, and although growth has held up better in France and Spain, most economists reckon that growth in the euro area as a whole was close to zero in the quarter. Nobody is forecasting an actual recession in the euro area this year, but it is no longer expected to provide an engine for world growth.

As for Japan, it is probably already in recession. Japan's GDP grew slightly in the first quarter, but only because consumer spending was boosted by the introduction of a new recycling law which encouraged households to bring forward purchases of fridges and televisions. Goldman Sachs reckons that figures due on September 7th could show that GDP fell at an annual rate of as much as 6% in the second quarter, and the contraction has almost certainly continued into the second half of the year.

Persistent deflation continues to weaken spending by increasing the real burden of debt and encouraging consumers to put off spending. A revised measure of Japan's consumer-price index, due to be published next week, is likely to show that deflation is worse than had been thought. The new index will include more up-to-date weights and new goods whose price has fallen sharply, such as personal computers and mobile-phone charges.

In Japan, persistent deflation continues to weaken spending

Worries about a deflationary spiral prompted the Bank of Japan to announce last week that it would pump more liquidity into the economy, increasing banks' reserves at the central bank and buying more government bonds. It was a step in the right direction, but probably not enough to drive away deflation. The government's plan to cut public spending is also likely to depress the economy.

If one assumes that growth in the second quarter was close to zero in America and the euro area, and that Japan contracted sharply, the combined GDPs of the rich economies will have contracted for the first time since late 1990. But, unlike 1990, a growing number of emerging economies are also sliding into recession.

United we fall

Some of the numbers coming out of East Asia are truly scary. Singapore and Taiwan have both seen two quarters of shrinking GDP. Singapore's fell at an annual rate of 11% in the first half of the year, Taiwan's at a rate of 6%. South Korea's economy has slowed sharply, and second-quarter figures are likely to show that Malaysia and Thailand are also dangerously close to recession. J.P. Morgan estimates that emerging East Asia, excluding China, contracted in the second quarter and will do so again in the third quarter.

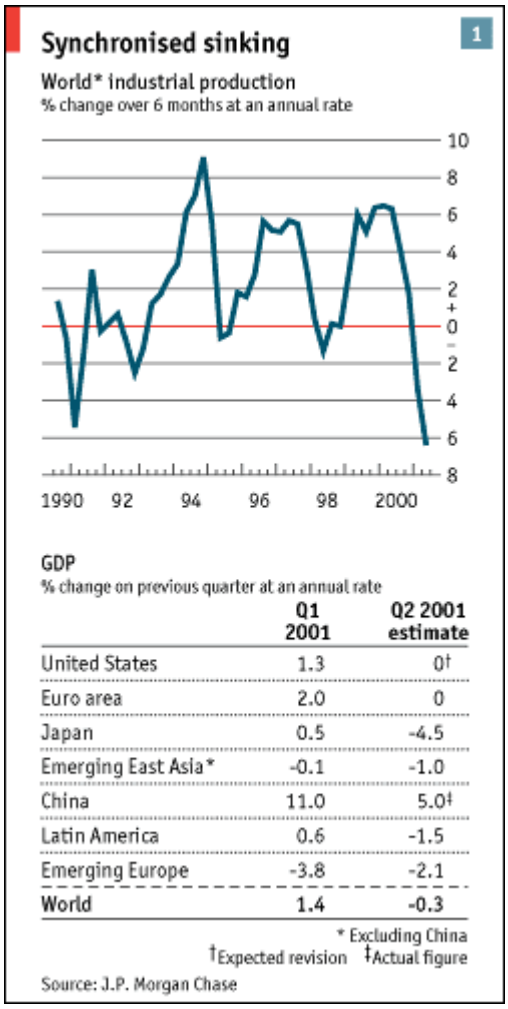
East Asia's problem is that the region had been over-reliant on exports of information technology (IT) equipment to the United States. America's IT investment boom allowed the Asian economies to recover much faster than expected from their financial crisis in 1997-98, but as the boom has turned to bust they are now being dragged down. Taiwan's total exports fell by 28% in the year to July. As well as a collapse in exports, Asia also faces a huge overhang of capacity and hence the risk of a sharp plunge in investment.

Although America's slump may be the main culprit, the former East Asian tigers also have themselves partly to blame. The strength of their rebound bred complacency about the need for structural reforms, such as cleaning up banks and cutting corporate debts. As a result, the growth in domestic demand has been relatively weak, making economies even more dependent on exports. South Korea's exports of goods and services jumped from 30% of GDP in 1996 to 45% last year; Thailand's from 39% to 66%.

Asia is thus more exposed to a global slump than ever.

In Latin America, Argentina and Mexico are already in recession and Brazil looks likely to follow after its GDP fell at an annual rate of 4% in the second quarter. Argentina's problems stem from the peso's rigid link to the dollar, which has eroded competitiveness and forced up interest rates on its massive debts. Brazil has been hurt by financial contagion from its neighbour; Mexico's headache is that its exports to America amount to 25% of its GDP. Mexico's GDP has now fallen for three quarters in a row.

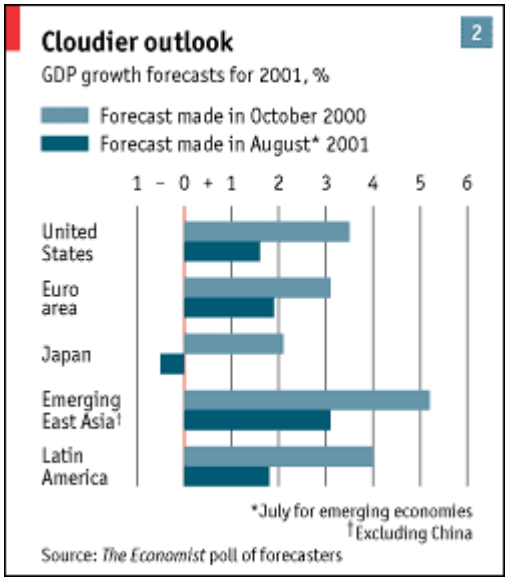
There are some exceptions around the world of economies that seem relatively untouched by the global downturn. For example, although China's growth slowed to an annualised 5% in the second quarter, it is still tipped to grow by almost 8% for the year as a whole, and India by 5%. But with output flat or falling in the second quarter in economies that among them account for two-thirds of world output, the world may already be in recession (see chart 1).



The most striking aspect of the current slowdown is that it is more widespread than in previous world slumps in 1975, 1982 or 1991. Those three years were all officially designated as world recessions, yet global GDP growth ranged between 1.2% and 1.9%, as recession in some parts of the world was offset by growth elsewhere. (This is why growth of 2% or less is generally considered to be a world recession.) In 1975, even as the jump in oil prices pushed rich economies into recession, Latin America and Asia remained relatively strong. In 1990-91 America went into recession, but Japan, Germany and most emerging economies continued to boom.

The world economy grew by 4.8% in 2000, its fastest since 1984, and most economists had expected 2001 to be another bumper year. Even those who predicted a hard landing for America's economy did not expect the whole world to slump with it. The downward revisions to 2001 growth forecasts have been unusually abrupt (see chart 2)—and they are probably still too rosy. What went wrong?

At least four negative forces have driven the global slowdown:



• First, and most important, the global IT boom has turned to bust. It was obvious last year that America's IT bubble was bursting as the Nasdaq collapsed and dotcoms went bust, but it was not widely appreciated that this was much more than just a narrow bubble in Internet stocks. Instead, "new economy" hype had distorted the global tech sector and unbalanced the entire American economy.

Over-exuberance about future profits and cheap capital had encouraged a lot of overinvestment, especially in IT. The consequent collapse in capital spending this year has hammered IT manufacturers at home and abroad. In the second quarter, business investment fell by an annualised 15% in America and by an estimated 18% in Japan, according to Morgan Stanley.

• A second and related dampener on growth has been the collapse in stockmarkets everywhere, which has eroded households' wealth and hence their desire to continue spending at the pace of last year. The 28% average fall in share prices since early 2000 has wiped $10 trillion off global wealth. Stockmarkets have fallen by even more in Europe and Asia than in America. Households in Europe hold fewer shares than their American counterparts, so the wealth effect on consumers is smaller. However, the plunge in share prices has seriously dented business confidence and investment plans.

A recent study by the IMF found that, whereas changes in the value of non-tech shares have little impact on consumer spending or investment in Europe, each dollar increase or fall in the value of tech shares has as big an impact on investment and spending as in America. This may explain why the bursting of America's tech bubble has dented Europe's growth by more than expected.

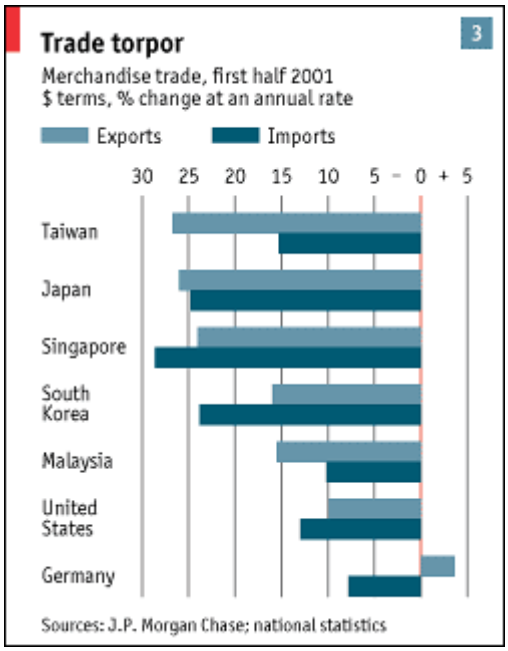
• The jump in energy prices last year reduced real incomes in oil-consuming economies and squeezed firms' profits. The economic impact of higher oil prices has been smaller than in the 1970s, because rich economies today use only half as much oil per dollar of GDP as they did. Nevertheless, higher oil prices have clearly reduced global growth.

• Last, but by no means least, the spillover from America's downturn to the rest of the world has been more powerful than in the past. As the world economy has become more integrated, a downturn in one economy spreads faster to another. During the past few years the world was hugely dependent on America as an engine of growth. Stephen Roach, at Morgan Stanley, reckons that the United States accounted for two-fifths of world GDP growth over the past five years, either directly or indirectly by sucking in imports from other countries. That dependence left the world more vulnerable to an American slump.

Economies have become more closely connected to America through trade, global supply chains and multinationals. Over the past decade world trade has grown 2.3 times as fast as world GDP, compared with only 1.4 times in the previous two decades. American imports now amount to 6% of the GDP of the rest of the world, twice as large as in 1990. But in the first half of this year, American imports fell at an annual rate of 13%; imports of IT equipment fell at a rate of almost 50%.

Industrial supply chains have become increasingly globalised as firms in rich economies outsource production to cheaper places, such as East Asia. Two-fifths of the growth of non-Japan Asia in 2000 was due to an increase in IT exports to America. But conventional trade statistics understate the increase in business linkages, because multinationals are playing a growing role. In 1998 the local sales of American affiliates of German firms were nearly four times their exports to America. So the slump in America has squeezed parent companies' profits. American multinationals have also responded to the slump at home by trimming output and jobs in Europe and Asia, transferring the blight from one region to another. Similarly, Fujitsu, a troubled Japanese electronics firm, has just announced that it will slash 16,400 jobs, 10% of its global workforce. Most of the cuts will be outside Japan.

During the good times, the increased interconnections of economies allowed other countries to share in America's boom. Now, however, America is exporting some of its recession abroad by importing less. In turn, economies hurt by America's downturn buy less from the United States and the rest of the world, which depresses demand further. In the first half of this year, Asia's exports and imports both fell by around 20% at an annual rate (see chart 3). Indeed, global trade is screeching to a halt. The Economist Intelligence Unit, a sister company of *The Economist*, forecasts that growth in the volume of world trade will drop to only 3% this year, from 13% in 2000. That would be the sharpest slowdown since 1975.



The long and the short of it

How long will the world economic downturn last? Most economists still expect both the American economy and the world economy to bounce back by the end of this year. Goldman Sachs, for instance, reckons that global economic activity will reach a trough in the present quarter. However, it expects a sluggish recovery.

There are two reasons for optimism. First, largely thanks to the cut in American short-term interest rates from 6.5% to 3.5%, the money supply in rich economies has accelerated sharply. If monetary policy worked with the same lags as in the past, the world could look forward to a strong rebound next year. Second, oil prices have fallen, pulling down inflation and pushing up real incomes and profits.

But unfortunately, the balance of risks lies on the downside. Top of the list is the risk that America may go into recession as rising unemployment curbs consumer spending. Were the dollar to go into freefall, as opposed to a measured decline, that too could cause a collapse in economic confidence. America's economic downturn is also likely to last a lot longer than had once been expected. It is different from other economic cycles since the second world war. Typically, recessions have been caused by high interest rates imposed to fight excess demand and inflation. Instead, this has been an investment boom-bust cycle, more like recessions before the war. In investment-led cycles, interest-rate cuts tend to be less effective in spurring demand until excess capacity and debts have been reduced.

This downturn is part of an investment boom-bust cycle, different from other economic cycles since the second world war

Then there is the risk that Argentina might yet default on its debt. This week the IMF agreed to a new $8 billion loan for Argentina. But it is only a stopgap. The fiscal austerity required to meet the IMF‘s conditions are likely to prolong Argentina's recession. The good news is that the risk of widespread contagion from Argentina to other emerging economies may be smaller than a few years ago. Most emerging economies have larger foreign-exchange reserves, less short-term debt and floating exchange rates. Investors also seem to discriminate more among borrowers. However, if Argentina does eventually default, other emerging economies would surely suffer.

Perhaps the biggest downside risk is that American share prices still look overvalued. Indeed, the recent downward revisions to both productivity growth and total profits as measured in the national accounts has increased the likely extent of that overvaluation. One of the success stories of the new economy was supposedly the surge in productivity and profits in the late 1990s. But official number crunchers have recently rewritten history. It turns out that productivity growth was a bit less miraculous than first thought, while the profits boom of the late 1990s was mostly an illusion.

The new figures, which take account of the true cost of stock options, show that profits have been falling as a share of national income since 1997. The reductions in productivity growth make analysts' forecasts of long-term profits growth—and hence share prices—look even more ridiculous. They also suggest that America's sustainable rate of GDP growth is well below what it has enjoyed in recent years.

The risks of a deeper global slump remain high. But even if America avoids a recession this year, it is unlikely to return soon to the go-go days of recent years. Many American investors and consumers have yet to wake up to this fact.

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Welfare reform

America's great achievement

Aug 23rd 2001
From The Economist print edition

Welfare reform has worked better than anyone expected. That does not help policymakers decide what to do next

Get article background

Topham

AUGUST 22nd marked a milestone in American social policy. On that day, five years ago, Bill Clinton, having promised to “end welfare as we know it”, signed into law the Personal Responsibility and Work Opportunity Reconciliation Act, otherwise known as welfare reform. This ended welfare as an entitlement, available to all the parents who qualified, and required recipients—mostly single mothers— to look for work. Rather than simply paying up on demand, the federal government switched to a “block grant” programme, handing over a fixed sum to states ($16.5 billion a year), to disburse as they wished, within limits. There are now, in effect, 51 different plans—one in each state plus a central set of guidelines.

One of those guidelines stipulated that poor people with dependent children would get federal payments for only five years over a lifetime. Their time is up, so payments to parents who have been on the rolls since then should stop. In fact, things should not change much. No one is sure how many of today's 2m welfare families have been on the rolls for the maximum period. Not many probably, because the states have already pushed some recipients off the lists; and the 1996 law also allowed them to exempt up to a fifth of welfare recipients from the five-year time limit. More generally, federal payments now make up a smaller portion of the welfare system than payments from states and local governments.

Still, the beginning of the end of federal welfare funding marks a natural point of reflection for “the most sweeping social change in America in more than half a century” (as Tommy Thompson, one of the reform's pioneers and now its overseer as secretary for health and human services, has put it). Congress must also reauthorise the law next year. What has welfare reform achieved? And can it be improved?

When the reform became law, welfare rolls were near their all-time high. The “revolutionary” Republican Congress of Newt Gingrich tried to turn several social programmes—including Medicaid, the part-state, part-federal health-care system for the poor—into block grants. Welfare was the only Republican plan Bill Clinton did not veto. And he signed it in the teeth of vociferous Democratic opposition.

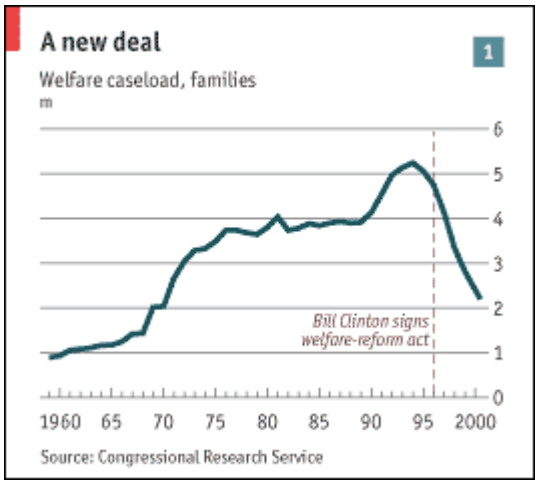
Welfare is only part of the country's poverty-reduction system, which includes public housing, food stamps, day-care subsidies, Medicaid and the Child Health Insurance Programme. But it has long been the most notorious part, not just because of its scale (in the mid-1990s, one in seven children was on welfare) but because it supposedly bred a culture of dependency.

The first aim of the 1996 law was to break that culture by moving people off welfare and into jobs. Before the reform, states gave out about 80% of the federal money that they dispensed in cash benefits. Now only half goes in cash. The rest goes on job searches, education, training and day-care for children of working mothers. Welfare offices have turned from cash-dispensing machines into job-centres, all using different sticks and carrots to push welfare recipients into work.

Critics on the left predicted disaster: unskilled welfare recipients would be unprepared for the discipline of work. In fact, welfare rolls have fallen more than even supporters predicted: from 5.1m families at the peak in 1994 to just over 2m now (see chart 1). In Wisconsin, where Mr Thompson was governor, Florida and Mississippi the rolls fell by more than 75%. Around two-thirds of those who left welfare are still

working. Of the large minority, some returned to welfare, some subsist on other forms of government support and a few—an unknown number—have fallen through the cracks.

The unemployment rate for single mothers had been stuck at around 43% for most of the 1980s and early 1990s. After reform, the rate fell to 28% by 1999. The unemployment rate of never-married mothers fell even faster, from just over half in 1996 to one-third three years later. In the early 1990s, the average stay on welfare had been more than eight years: dependency, indeed. Now, the stay is probably less than half that. In the narrowest sense of the law's aim, it has been a triumph.



This has not been achieved merely by skimming the cream: the worry was that the employable minority would find jobs quickly, leaving behind an unemployable residue who would not find work, even if their benefits were cut off. At some point, presumably, the law of diminishing returns must set in. But that point has not been reached yet.

Studies by the Urban Institute, a Washington think-tank, show that the most recent batch of welfare leavers (those who left in 1997-99) have similar levels of employment and wages as the first batch (who left in 1995-97). And they suffer less hardship than the earlier group, with “only” 41% living below the poverty line, compared with 48% in 1997. There has been no build-up of the worst cases on the rolls. Welfare recipients seem far more employable than critics feared.

It's not the economy, stupid

The reforms took place at a time of unprecedented economic growth. Some wonder whether their success has been enhanced by transient economic factors that have begun to change. Just before the economic slowdown became apparent there was a rise in the caseload between July and September 2000—a mere 8,000 families, but the first time that more than a handful of states had seen the numbers rise.

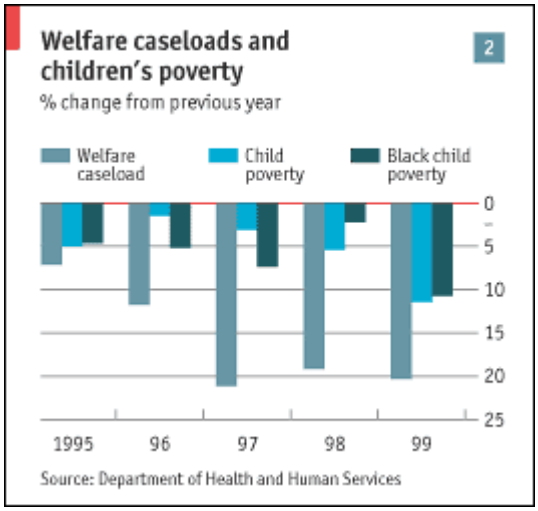
Yet the connection between welfare rolls and the economy is less firm than you would expect. During the 1980s, when America added 20m new jobs, welfare rolls grew by over 500,000 families. Rolls also rose quickly at the beginning of the economic recovery of the early 1990s. The good news did not begin until 1994—when welfare reform began experimentally in some states. It was strongest in those, such as Wisconsin, that went furthest with their own reform measures.

A review by the Urban Institute shows that six studies before 1996 all gave more weight to the economy than policy. Two even found the economy accounted for three-quarters of the change in caseloads. But the two more recent studies of effects after 1996 placed policy above the economy by a ratio of at least four to one.

This hardly settles the argument conclusively. The success so far must owe something to the economy—and a downturn will, at the very least, affect the pace of improvement. On the other hand, worries about the economy should not be allowed to denigrate the achievement. Reform has left recipients better off than they would otherwise have been.

“Better off”, however, does not mean much. The first aim of reform was to get people into jobs; the second was to improve the income of the poor. Here reform has been less successful. Reductions in poverty have occurred, but at a slower rate than reductions in welfare rolls (see chart 2).

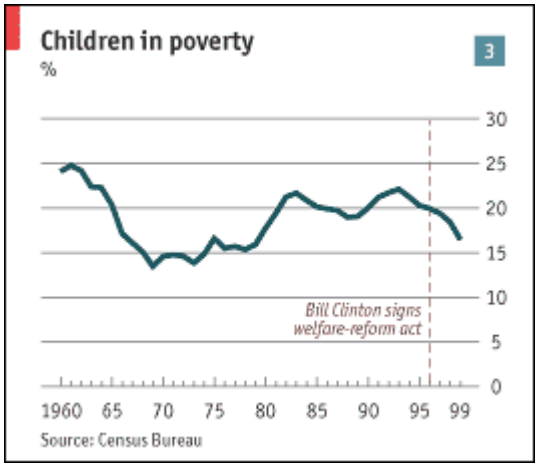
In terms of wages, poor parents improved their lot (albeit at miserable levels). Annual wages for the bottom fifth of single-mother households rose from $1,350 in 1993 to $2,400 in 1999—a nominal rise of more than 80%. Earnings for the next 20% of wage earners increased even more, from $4,800 to $9,600.



Employed, but not richer

The trouble is that for every dollar gained in extra earnings, people lost around 40 cents in benefits. The poorest 40% of single-mother households increased earnings by about $3,000 between 1993 and 1999. But their disposable incomes rose by only about $1,850. The poorest of all have been hit hardest. According to Wendell Primus, a former Clinton administration official, and Ron Haskins of the Brookings Institution, 700,000 families are worse off under reform than they were before; and the child-poverty gap—the total amount that would be needed to bring all children up to the poverty line—fell only slightly in 1993-99, from $59.8 billion to $56.3 billion.

That still marks an improvement in the number of children escaping poverty. Until the mid-1990s, the proportion of children living in poverty had been rising erratically (see chart 3). Since then, the trend reversed sharply. In 1999, the child-poverty rate was back to its lowest since 1979 and poverty among black children was at its lowest level ever. Using a broader measure of poverty, the decline in poverty has been comparable to the big gains of the 1960s and was more than twice as great as during the 1980s.



Yet the fact remains: poor parents have seen less improvement in incomes than in their chance of a job. This gets more troubling when you look at wider benefits to children (such as higher school grades and keeping out of trouble with the law). Such things, according to a study of 11 different welfare schemes by the Manpower Demonstration Research Corporation, improve significantly only when the reforms boost both jobs and income.

But breaking the culture of dependency had wider goals than these. If you read the early pages of the welfare-reform bill, it is startling to find how often the word "marriage" appears. Welfare reform, for many of its proponents, was not to be judged by economic statistics. Rather, as one commentator, Mickey Kaus, says, it was about taking a "culture characterised by welfare dependence, a high rate of births out of wedlock, high male unemployment, and crime and replac[ing] it with a new, more virtuous social dynamic." Marriage is the best indicator of this complex change—and it is here that the most surprising good news is to be found.

For decades before welfare reform there had been a relentless rise in the number of out-of-wedlock births (from 18% in 1980 to 33% in 1999). The number of children living with single mothers was especially marked among the poor and among blacks. Yet in about 1996, these apparently unstoppable trends stopped. According to a study by the Centre for Budget and Policy Priorities (CBPP), the share of children living with single mothers on less than twice the poverty rate fell from 34.2% in 1995 to 32.8% in 2000. This group includes most welfare recipients.

The revival of the nuclear family in the past few years has been driven by many things (from education to a new long-lasting injectible contraceptive). But it has been particularly notable amongst welfare beneficiaries. The proportion of black children living with their married parents rose from 35% in 1995 to 39% in 2000—a rise almost three times bigger than that in the whole population. And a welfare

programme in Minnesota which rewarded married couples has yielded startling results. After three years, married couples on the scheme were considerably more likely to stay together than comparable couples on other programmes. Single parents joining the programme were also slightly more likely to get hitched.

One of the authors of the CBPP study, Mr Primus, resigned from the Clinton administration in protest at the decision to sign welfare reform. He now credits that change for creating this most unexpected good news on the family. “Whatever we have been doing over the last five years,” he says, “we ought to keep going.” That depends on Congress, which has to reauthorise the welfare laws by October 2002.

There is no constituency for a radical overhaul. Welfare hardly merited a mention in the presidential election last year—a remarkable testament to the way in which success in the field has produced political consensus out of controversy in five years. However, there is still room for Congress both to mess things up and improve them.

The big danger, inevitably, involves money. Some congressmen cite the plummeting welfare rolls as a reason to chop the block grant. Yet part of the success of the block-grant system is that, as those falling rolls have left behind the harder cases, it has increased the amount of money available to find jobs for each of those people. That virtuous circle would turn vicious if the money were reduced. Indeed, the possibility of recession suggests that the $2 billion contingency fund—which provides extra money for hard-hit states—should be both increased and made easier to tap. At the moment, states virtually have to declare bankruptcy to get the cash.

The problems to do with “ancillary benefits” (like food stamps) fortunately do not require Congress to authorise more money, just to simplify the rules. Fewer than half the working mothers who leave welfare continue to get food stamps, even though they are entitled to them. Cutting red tape—both at state and federal level—would do more than any single thing to boost the disposable incomes of welfare-leavers and to reduce child poverty.

The third tricky area is how much welfare reform can be used to promote marriage. This is mostly a matter for the states, and at least two—Oklahoma and Arizona— have set up ambitious programmes that are supposed to boost marriage rates among the poor (including marriage-training classes). Congress could set up additional matching funds to encourage such programmes. Perhaps more important, it could end the marriage penalties in its own tax code, especially in the earned-income tax credit. A study by the Urban Institute found that if a single working mother on the minimum wage marries a man earning $8 an hour, she loses a staggering $8,060 in annual benefits.

These problems are mere sun spots. It is rare enough that any government policy, let alone one dealing with poverty, is so near an unambiguous success as welfare reform has been. For decades, the underclass has loomed as America's deepest social problem. In just five years, reform has halved the size of the problem and made it possible to move on to the next stage. Pray that Congress doesn't blow it.

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Jesse Helms

Should he be missed?

Aug 23rd 2001 | CHAPEL HILL, NORTH CAROLINA
From The Economist print edition

The senior senator from North Carolina will retire in 2003.

IN THE past few years, Jesse Helms of North Carolina has become an elder statesman in the Senate, praised by Bill Clinton's secretary of state, Madeleine Albright, and leading delegations to Mexico and the United Nations, both targets of his ferocious crusades. This week he said he would not run again next year. Despite his courtly manner in private, which so charmed Ms Albright, the mantle of statesman seems misapplied for the old curmudgeon. Throughout a three-decades-long Senate career, Mr Helms was a polarising figure, a product of the Old South who rearranged the region's political landscape in a much less gentlemanly way.

Mr Helms, the son of a small town police-and-fire chief, spent the 1960s as a commentator on a television station in Raleigh, the state capital. His searing editorials, broadcast across the state's coastal plain, voiced the anxieties and grievances of white southerners at a time of roiling social change. Then, and later as senator, Mr Helms often defined himself by what he was against—communists, the civil-rights movement, gays, liberals.

After he joined the Senate in 1972, Mr Helms was at first overshadowed by Sam Ervin, a North Carolina Democrat who presided over the Senate's Watergate investigation. Mr Helms emerged as a force in the Republican Party in 1976, backing Ronald Reagan's campaign against President Ford. With Mr Helms's help, Mr Reagan won the North Carolina primary, though he lost the nomination. Still, that North Carolina victory kept alive his presidential hopes for 1980.

Though Mr Helms supported Mr Reagan and considered him a friend, the two were sometimes at loggerheads, especially over foreign affairs. That became a constant theme: Mr Helms often seemed to be running his own foreign policy. He delayed Senate approval of several Reagan appointees, just as he would later do with appointees of President Clinton and both George Bushes. He cast the only vote in the Senate against a resolution backing Britain in the war with Argentina over the Falkland Islands. He supported the contra war in Nicaragua, as did Mr Reagan. But he went further in giving support to El Salvador's Roberto d'Aubuisson, who was linked to the “death squads” of that time.

Many conservatives loved this unilateralist, sometimes isolationist, vigour. Even some who do not share his views defend Mr Helms on the grounds that he represented a significant strand of American public opinion, which it was better to have expressed inside the corridors of power than leave to fester without. They point, in particular, to his long campaign to force the United Nations to reform itself by withholding American dues.

The trouble was that the Senate's intricate rules also enabled him to conduct quixotic crusades—most

notably when he refused to hold a vote to confirm the nomination as ambassador to Mexico of William Weld, a moderate Republican from Massachusetts, whose social views he rejected. In 1979, two Helms aides showed up in London to monitor negotiations over the independence of Zimbabwe, eliciting a protest from the British government that the senator's staffers were encouraging the former Rhodesian prime minister, Ian Smith, to hold out longer.

For much of his career, Mr Helms was in the Senate's minority party. He seemed more comfortable hurling thunderbolts in opposition than fashioning initiatives in a majority. When Republicans won control of the Senate in 1994, however, Mr Helms rose to chair the Senate Foreign Relations Committee, the most powerful post he held. There he tightened the screws on Cuba, writing the Helms-Burton amendment which extended American law extraterritorially to foreign companies doing business with Fidel Castro—to the fury of America's allies. And he bullied Mr Clinton into acquiescing to his line on the UN.

These stands, which even some opponents would concede to be principled, need to be set against his influence on the conduct of domestic politics—which was arguably both greater and more pernicious. Shortly after he won his first re-election, Mr Helms set up a political-action committee that set new standards for nationwide fund-raising through the direct mailing of inflammatory letters.

In 1984, in a re-election campaign against the Jim Hunt, a popular Democratic governor, the Helms forces launched a ferocious assault on Mr Hunt's reputation and record in a television advertising campaign that went on for 15 months. In that campaign and again in his 1990 battle with Harvey Gantt, the black former mayor of Charlotte, Mr Helms set new standards for destructive and downright racist advertising.

Mr Helms never got more than 55% of the vote in five election campaigns. His views and his tactics split the electorate into two blocks, pro- and anti-Helms. He sought just enough of a majority for victory and damned the rest of them.

Partly for that reason, Mr Helms leaves behind neither a political organisation nor an obvious successor. Some Republicans want Elizabeth Dole, a former cabinet officer whose mother lives in Salisbury, North Carolina, to run. But she may be opposed for the party's nomination by candidates with deeper roots in the state. With the retirement of that other relic of segregation, 98-year-old Strom Thurmond of South Carolina, the Republicans must defend two Senate seats in southern states that have just elected Democratic governors.

The Republican candidate should still be favourite. Last year, the state gave its electoral votes to President Bush by a convincing margin. But whoever succeeds him will surely not possess that Helmsian combination of a pre-1945 world-view and old-South social attitudes that led him to practise such hard-edged, oppositional politics.

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Massachusetts politics

Queen Jane II, or was that IV?

Aug 23rd 2001 | BOSTON
From The Economist print edition

A little marital difficulty for the governor

JANE SWIFT must feel grateful, at times, that the public cares about her personal life. After all, her newborn twins nearly saved her political reputation. When she became Massachusetts's acting governor this spring—after the previous occupant skipped off to an ambassadorship—she was best-known for a string of scandals that had plagued her as lieutenant-governor. But she was pregnant, and thus treated to gushing TV interviews, national attention, and the requisite happy photographs of mother and babies. When “Queen Jane” went on “working maternity leave”, her foes didn't dare attack—and her approval ratings soared.

But the Massachusetts media pack has sharp, pointy teeth, and it pounced when Ms Swift returned to work this summer. Her 25-year-old stepson provided a reason. He called a newspaper to gripe about Ms Swift's opposition to gay marriages, but he dropped a more intriguing titbit in the process: Ms Swift was not her husband's second wife. She was his fourth.

As scandals go, this must be one of the smallest ever. True, there was some wrongdoing involved: Ms Swift and her husband lied on their marriage-licence application, saying he had been married only once before. But this is mostly a juicy piece of water-cooler gossip. Even Ms Swift's close friends and aides didn't know this fact about Chuck Hunt, her publicity-shy husband who, at 47, is 11 years older than she is. Ms Swift has said she lied because she wanted to protect him—presumably, from just this sort of circus.

Even some Democrats are rushing to the Republican governor's defence. Every politician faces scrutiny, but “we've now hit the lunatic level,” says Pat McGovern, a former state senator and Democratic candidate for governor. But Tobe Berkovitz, a professor of communications at Boston University, has far less sympathy. Mr Hunt, he points out, was willing enough to appear in soft-edged newspaper stories about the state's First Family. Now he should be ready to face inquiries about the rest of his life.

Deserved or not, this attention is thwarting Ms Swift's attempt at a political resurrection. Elections for governor are due in a year's time, and for a while she had seemed the front-runner. But each time a new embarrassment crops up, the voters get reminded of some pesky old ones: a state-paid helicopter ride home to look after a sick child, a habit of using aides to baby-sit her older daughter, an exorbitant salary she took to teach a course at a local college. They might start to remember why they disliked her in the first place.

Ms Swift, it is clear, has taken some lessons from her previous brushes with scandal. In the past, she was defensive; this time, she apologised quickly. Then she used the power of her office to divert attention, announcing, appropriately enough, a sweeping maternity- and paternity-leave programme. Still, she must have learned a couple of sobering lessons in the last week: that voters' warm feelings can dissipate fast, and that the public never loses its appetite for bad news.

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Illinois politics

A Daley dynasty?

Aug 23rd 2001 | CHICAGO
From The Economist print edition

The prospect of one family holding the state's two biggest jobs

IF POLITICS can get into one's blood, then Bill Daley is badly infected. Mr Daley was Bill Clinton's secretary of commerce and Al Gore's campaign chairman. More famously, he is the son of Richard J. Daley, Chicago's mayor for two decades, and the brother of Richard M. Daley, the current mayor, who has proved (in a much nicer and non-venal way) to be every bit as wily and powerful as his father. Now Bill Daley, a Democrat like the rest of his family, could be governor of Illinois.

Mr Daley says he is leaning towards running and will announce his plans in the next few weeks. If he goes for it, he will leap near the front of a crowded field of candidates hoping to replace the current Republican governor, George Ryan, who has said he will not run again. Mr Daley starts with a brother whose approval rating as mayor of Chicago lingers near 80% and the best-known name in state politics since Abraham Lincoln (oh, alright, you pedants: Adlai Stevenson). His Palm Pilot—a present from Al, no doubt—is packed with state and national contacts from his days running presidential campaigns. Rich friends could be very valuable since Illinois has no limit on individual campaign contributions.

Might two Daleys in power be too many?

Yet the Daley name would be a drawback, too. Chicago voters would be keen to have even more clout in Springfield, the state capital; suburban and "downstate" voters might be less excited by the idea. "I'm from a small town downstate, and I never heard anything good about Chicago or its politicians," says Bill Wheelhouse, a political reporter for Illinois Public Radio. Chicago is notorious—rightly or not—for siphoning funds away from the rest of the state; the Daleys are the consummate deal-cutting Chicago politicians. Might two Daleys in power be one too many? "He was secretary of commerce and I didn't take over the United States," scoffs the mayor.

The head of the Illinois Democratic Party, Michael Madigan, has encouraged Mr Daley to run. For many Illinois Democrats, Mr Daley is simply the person with the best chance of getting them back to power. Despite voting for both Messrs Gore and Clinton, the state has not chosen a Democratic governor for nearly 25 years. If Mr Daley looks like a winner, Democrats all over the state will forgive him his last name.

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Pow-wows

Drumming in the good old way

Aug 23rd 2001 | LOVELAND, COLORADO
From The Economist print edition

An old religion is reborn, in very different surroundings

BEFORE any of the Indians will dance, the tobacco does. A smattering of tobacco is put on the membrane of the big drum, which is hit softly by the five men sitting around it. One, in a T-shirt and baseball hat, lets a toddler on his lap work the stick for a bit. Another, in a leather jacket adorned with beads and feathers, presses a cassette recorder against his ear, learning a song his friends will soon sing as loud as they can in a language that many of them do not understand.

This group is one of four such “drums” at the Northern Colorado Intertribal Pow-Wow. Some drums bear evocative names, such as the Long Walk Descendants. Others are more whimsical: the Dead Grass Singers are supposed to make people dance until only bare earth is left. The highlight of the morning is the Gourd Dance.

Rattling gourds and waving fans made of feathers from eagle-hawks or red-tailed hawks, members of the Gourd Dance Society sway to the singing and drumming. Parts of the dance are dedicated to specific causes, such as ex-servicemen and (this pow-wow's special theme) fathers and sons. At the end, a blanket is produced for a graceful piece of fund-raising. Travel has to be paid for, from as far away as New Mexico and Oklahoma, and the head dancer is expected to give away expensive presents, such as blankets, to show his appreciation of the honour.

The summer pow-wow season is an important event for many of the 4.1m Americans who claimed some Indian blood in last year's census. Pow-wows are supposed to have started on the Great Plains, where different tribes would meet during hunts and exchange news and songs. In the late 19th century, the federal government, fearing war councils, forbade all dancing outside rodeos and shows, such as the “demonstrations” of Indian life that Buffalo Bill took around the world.

Bearing that in mind, the Loveland pow-wow is held indoors, in a building next door to the rodeo arena at the Larimer County Fairgrounds. Many of the participants come dressed in different versions of Red Indian garb, with feathers, leather and bells, partly in the hope of winning one of the cash prizes at the dance, which forms the second part of the event.

This mix is not everybody's cup of tea. Paul Apodaca, of Chapman University in Orange, California, argues that current pow-wows, a sort of ecumenical modern folk dance, bringing in the customs and songs of more than one tribe, would be unrecognisable to his Navajo ancestors. The rodeo pow-wows are frowned upon by traditionalists on reservations, where around 800,000 American Indians still live, and where the distinct rituals of particular tribes are sometimes still practised.

But current pow-wows might be unrecognisable to their originators

But for the 1m or so American Indians who now live in big cities, pow-wows have been an important cultural anchor. As Donald Fixico of the University of Kansas points out in a recent book*, many Indians who left the reservations, prodded by the Bureau of Indian Affairs, have been homesick for Indian traditions, such as the communal approach to ownership. Ever since the 1950s, Indians of different tribes have found each other at pow-wow societies in places like Chicago, Denver and Los Angeles. For their offspring, the dances, the giveaways and the veneration of a deity called the Creator are what being an Indian is all about.

This culture is still under development. At the Loveland pow-wow, the spiritual adviser, Charles Bearrope, who was born on a Dakota reservation, told the dancers that, as an innovation, he had taken a traditional Lakota sweat-bath (a kind of religious sauna in a lodge) before he arrived, but he had not finished the

ritual. Instead, he would conclude the rites at Loveland, thus tying the whole pow-wow into the ancient ceremony—including an invitation to the following weekend's pow-wow in Frazier, Montana, where the best dancer was to get $1,000 and a horse.

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*"The Urban Indian Experience in America". University of New Mexico Press, 2000.

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Lexington

That shrinking feeling

Aug 23rd 2001
From The Economist print edition

The Democrats are wrong to be so cock-a-hoop about the disappearance of the surplus

WASHINGTON, DC, has been declared a federal disaster zone. Days of torrential rains overwhelmed the city's sewers, flooding basements with a stinking mess. How appropriate. Over at the White House, months of torrentially bad numbers have rained on the economic parade, overwhelmed the budget and are about to spread ordure all over the public finances.

This week, the bean-counters at the Office of Management and Budget finally admitted what everyone has known for some time: the much-prized budget surplus has all but disappeared. Back in April, the surplus for the current fiscal year was estimated to be $122 billion, if you exclude the Social Security trust fund; it is now just $1 billion—and that is only because the OMB fiddled the numbers to find an extra $4 billion in revenue. Just in case the message is not clear enough, next week the Congressional Budget Office is likely to say that the surplus has in fact vanished, and that the administration will have to dip into Social Security to pay its bills, which it has sworn not to do.

Democrats are hugging themselves. The party's chairman, Terry McAuliffe, calls the point at which the surplus disappeared “the defining moment of the Bush presidency”. In a little over six months, George (“Tax Cuts ‘R' Us”) Bush has squandered a budget surplus that took his predecessor years to accumulate.

Republicans are nervously saying that everything will be all right if only Congress keeps spending within the amount Mr Bush is demanding. But Democrat bigwigs are gleefully reminding anyone who will listen of embarrassingly brazen statements like this one from Dick Armey, the Republican majority leader in the House: “Let me just be very clear about this. The House of Representatives is not going to go back to raiding Social Security and Medicare trust funds.” Given gifts like that (the statement came out last month, when the administration was already raiding Medicare), it would require superhuman political restraint to refrain from shouting “We told you so.”

But hang on a minute. When you ignore the political grandstanding, what has actually happened? The government's fiscal position has gone from modestly deflationary to neutral. When it was in surplus, the government was taking more out of the economy in taxes than it was putting back through spending. Now it is in balance, so the fiscal stance has relaxed a little.

What is wrong with that? It is exactly what orthodox economics tells you is supposed to happen during a slowdown. This year, the growth in national income has gone from a sprint to a crawl. This has affected the budget in the

Dig through the political

most unexceptionable way. Lower-than-expected tax revenues accounted for a third of the decline in the surplus. Economists call this an “automatic stabiliser”: it allows a budget to help the economy adjust to harder times. It is working just fine. On top of that, this year's tax rebates will boost demand. Again, perfectly orthodox.

grandstanding and you will find orthodox economics

It would be another matter if the budget were swinging wildly from surplus to deficit, as Britain's did in 1988-92. That would raise worries about boom and bust. But it is not. The sums are big enough to make a difference, but not to upset the apple cart. Instead of complaining about it, Democrats ought to be taking credit for the change in the fiscal position. The current rebates were their idea (Mr Bush wanted to start tax cutting in 2002). If the economy does start to recover later this year or next, the supposedly ruinous disappearance of the budget surplus will have had a lot to do with it.

This is not to say that everything is hunky dory in budget-land. The ten-year tax cut is reckless in cutting revenues in the years before the baby-boomers retire, when their health and retirement costs will threaten to overwhelm Medicare and Social Security. It is also full of outrageous accounting gimmicks, especially towards the end of the period. These are huge problems, far bigger than the controversy over today's vanishing surplus. But they concern the long term, not the 2001 budget.

Similarly, the Democrats could claim that the basic design of the ten-year plan, in which tax cuts are back-loaded, may well be pushing up long-term interest rates, thus negating the Fed's short-term cuts in rates (including the one this week). But even this current problem comes from discounting future effects: those long-term rates are being held up by worries about what will happen to revenues in 2010 when the tax cuts will really have started to bite. It has nothing to do with this year's cuts.

Budget blues

The best ground for skewering the administration is not the disappearing surplus itself, but the bogus arguments advanced to pretend that this is not the case. For instance, Mr Bush's people like to say that congressional promises (by both parties) not to raid the Medicare trust fund are meaningless because there are no real assets in this fund. In a technical sense, this is true: the “assets” are government bonds held by another branch of the government. But the decision to tap Medicare's payroll taxes immediately rather than letting them be invested in Treasury bonds is far from meaningless. One policy boosts government spending, the other boosts savings—not a trivial distinction.

So Democrats have a lot to complain about, and Republicans to justify. Yes, the long-term budget outlook is worrying and some of the arguments being used to defend it are preposterous. But this does not alter the basic point now (and also for next year's congressional elections): that with the country on the verge of a recession, it makes no economic sense to be running—or defending—large budget surpluses. It should not be hard to explain to American voters that the federal government can afford to borrow a bit now, so long as surpluses build up again before the huge baby-boom generation retires. And the Democrats should bear in mind that, if the economy does rebound, then Mr Bush will be able to skewer them for being the people who tried to stop him making that happen.

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Argentina's economy

The austerity diet

Aug 23rd 2001 | BUENOS AIRES
From The Economist print edition

Whether or not the menu drawn up by the government and the IMF proves to be sustaining depends partly on a tricky reform of provincial finance

AP

Get article background

A WEEK later than advertised, Argentina's government got the help it had been seeking from the IMF, in the form of the promise of a new $8 billion loan. Added to $14 billion still left over from a previous agreement struck last December, officials hope that this money will restore confidence in their country's economy and in their ability to service the $127 billion public debt. In return, President Fernando de la Rua's government must stick to its “zero deficit” fiscal-austerity policy.

Prices of Argentine bonds and shares bounced on news of the deal, but optimism could be short-lived. The credit-rating agencies said that they saw no reason to change Argentina's “speculative” rating. Scepticism stems from doubts about whether the loan is big enough to end a three-year recession. Nor is it certain that the government can keep its fiscal vows.

Passed last month in response to a drying up of credit, the “zero deficit” law prohibits the government from spending more than it raises in taxes. To balance the budget, Domingo Cavallo, the economy minister, is relying mainly on cuts of up to 13% in state pensions and salaries. Discontent will grow if falling tax revenues lead to even bigger wage cuts.

The government has renewed its now habitual commitment to the IMF to crack down on tax evasion. But the agreement also contains a new promise to approve a law to reform provincial finance.

That will be tricky, though reform is clearly necessary. The government is forking out $17 billion this year to Argentina's 24 provinces, or nearly a third of total state spending. Even so, the provinces are budgeted to run a deficit of $3.2 billion, and have accumulated debts of $21 billion. The current system guarantees the provinces a monthly minimum of $1.35 billion regardless of falling national tax revenues, offering them little incentive to reform.

Reforming provincial finance is necessary, but tricky

Since 1985, governments have dodged the issue, preferring a patchwork of temporary fixes. The task will be no easier in the midst of a recession, particularly since opposition Peronists control the three biggest provinces. Part of the difficulty is that provincial governments act as an informal, but inefficient, social safety-net. In Argentina's poorer north-west, up to a quarter of the working population is on the provincial payroll.

There is also a wide disparity between provinces. Some, such as Santa Cruz, San Luis and the city of Buenos Aires, already have balanced budgets. An overall deterioration is largely due to the mess in Buenos Aires province, which contains a third of the nation's population and consumes the same proportion of provincial funds. Carlos Ruckauf, its governor, has done little to cut its deficit, apparently hoping that he could win a presidential election in 2003 before the province's finances fell apart.

No such luck. To cover this month's expenses, Buenos Aires has hurriedly had to issue $90m in small denomination provincial bonds, known as *patacones*. Despite protests and legal challenges, such Monopoly money this week made up part of employees' wage packets. The bonds will be accepted by the

utilities, large supermarkets, the tax authorities and even McDonalds, which is offering a special “Patacombo” menu for a $5 bond.

Such bonds have hitherto only been issued by small north-western provinces. But Mr Ruckauf is unrepentant, blaming Argentina's “bankruptcy” on Mr de la Rua. Other Peronist governors, too, are in little mood for compromise. Most say that their decision not to block the “zero deficit” law in Congress was the last favour the government can expect until after an election in October to renew the Senate and half of the lower house. This is likely to see substantial losses for Mr de la Rua's Alliance.

Provided that the IMF loan allows Mr de la Rua to struggle on until then, some Peronists might enter a new government coalition. Only a cross-party consensus of this kind can achieve a new provincial finance law. “Reform is impossible if the only thing being negotiated is that the provinces will receive less money,” says Norberto Sosa of Raymond James, an investment bank. “In a different context, with a restructuring of national and provincial debt, it could be done.”

In other words, the government's political weakness means that before tackling provincial finance, it may first have to reach a deal to restructure its debt. It can now count on the IMF's support in that. Argentina may have bought itself a few weeks in which to negotiate reforms. But it has done no more than that.

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Energy policy in Mexico

The cost of power conservatism

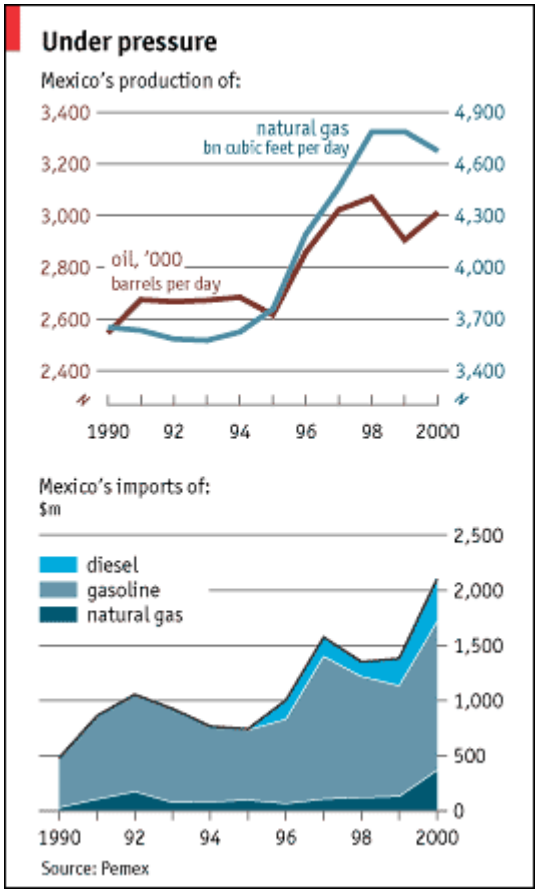
Aug 23rd 2001 | MEXICO CITY
From The Economist print edition

The United States wants energy from its neighbours. A report from Mexico, which is struggling to reform its inefficient energy industries; and a second from Canada, where some politicians sniff an opportunity

LAST month something rather novel happened to Mexican electricity bills: they started showing the true cost of the power consumed, so that domestic and farm users are reminded that they receive subsidies of up to 70%. As well as telling the ungrateful masses what a good deal they get, the idea is to make the state-owned electricity industry more open.

But that is only a tweak when what is needed is a huge overhaul of Mexico's energy industry. Mexico's new president, Vicente Fox, has accepted George Bush's call for a joint discussion, also involving Canada, on North American energy flows. But Mexico faces energy problems of its own.

Demand for energy is growing, yet the country's state-owned electricity and oil monopolies lack investment capital. But they also have powerful political friends, and have beaten back efforts to open up their industries to private investment. That makes energy reform one of the biggest challenges facing Mr Fox.



Take electricity first. Over the past decade, consumption has increased at an annual average rate of 5.1%. But generating capacity from the two electricity companies, Central Light and Power (LFC), which serves the capital, and the Federal Electricity Commission (CFE), for the rest of the country, rose by only 4.5% per year. The “operating margin”—the amount of spare capacity for emergencies, which the industry regulator says ought to be at least 6%—is now often near zero.

Planned new power plants should see Mexico through the next three years or so. But if the economy returns to the high growth rates of 1996-2000, things will soon get worse. Generating capacity now totals 36 gigawatts (GW). Depending on which official forecast you believe, Mexico will need new capacity of between 26 GW and 34 GW by 2010, and investment of between $50 billion and $65 billion.

The government wants at least half of that money to be private. But that will not be easy. Private investors are allowed to build and operate power stations for the state monopolies, or to act as “independent” generators, building power stations to supply specific large users, such as factories. Either way, CFE sets the price.

Since 1994, almost all new power stations have been privately built. But the CFE's last five tenders attracted only one bidder. “We need an open market in electricity to generate more interest,” says Eduardo Andrade, chairman of the Mexican Association of Electrical Energy, an industry lobby group.

Many politicians are fiercely opposed to ending the state's monopoly. Electricity was nationalised in 1960, partly to rescue struggling private firms. But misty-eyed nationalists link this to the expropriation of

foreign oil companies in 1938, still celebrated every year as a heroic event in the creation of modern Mexico. Changing the state's role means changing the constitution. Mr Fox's predecessor, Ernesto Zedillo, tried to part-privatise electricity but gave up under a hail of protest. Earlier this year, Mr Fox more timidly decreed that independent generators could sell any excess capacity to CFE. Hardly world-changing stuff: independent generators produce less than 3% of Mexico's electricity. Yet opposition legislators went to court to block the decree.

That is a bad omen for a government bill, due to be sent to Congress next month, which would set up the framework for an electricity market by separating generation, transmission and distribution. Everyone agrees that the electricity companies need more autonomy, to pay less tax so that they can invest more, and that subsidies should be rethought. But the left-wing Party of the Democratic Revolution and at least some members of the formerly-ruling Institutional Revolutionary Party, who between them dominate Congress, oppose any relaxing of the state's grip.

Even if the bill is approved, there is another problem. Most of Mexico's older power plants run on fuel oil, but the Energy Ministry reckons that by 2010, cleaner gas-fired power stations will account for 60% of generating capacity. And Mexico will not produce enough gas for them.

Burning issues

For that, blame Pemex, the state oil monopoly. It is the state's cash cow, contributing 37% of government revenues last year. As a result, for the past two decades it has suffered from underinvestment in all areas. As its gas output has faltered, imports have risen. By 2010, up to a quarter of the gas that Mexico will consume may have to be imported. “Mexico certainly has plenty of gas reserves waiting to be found. They're just not committing the capital to go look for it,” says Jed Bailey of Cambridge Energy Research Associates, an American consultancy. Underinvestment has also hit the output of crude oil and refined products like petrol.

As with electricity, Mr Fox has found even timid changes at Pemex thwarted. His attempt to appoint four businessmen to the board of directors was overturned in Congress. Raul Muñoz, the chief executive appointed by Mr Fox, is trying to bring Pemex's four near-independent subsidiaries—exploration and production, gas, refineries and petrochemicals—under more central control, to cut costs. So far, the result has been to swell bureaucracy and hold things up: only 20% of this year's investment budget has been spent, and production targets for the next few years have yet to be fixed, according to Hector Santana, who recently resigned from Pemex's planning department.

The simplest way to prevent the natural-gas shortage would be to end Pemex's monopoly, allowing competitors to tap the ample reserves. But that may be politically impossible. Alternatively, lighter taxes, as Mr Fox promised during his election campaign, would allow Pemex to invest more. But he has omitted this from a fiscal reform intended to increase Mexico's pitifully low tax take, which is scheduled for debate in Congress next month.

The government may be reluctant to relinquish revenue from Pemex until Congress has approved alternatives. But without a serious shake-up soon, Pemex will become a brake on Mexico's growth.

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Energy policy in Canada

Sandstorms

Aug 23rd 2001 | OTTAWA
From The Economist print edition

Talk of a North American energy policy has fuelled political rivalries

WHEN earlier this year George Bush started talking about his desire for a “common North American energy policy”, the immediate reaction in Canada took the characteristic form of an undignified squabble between the provinces and the centre as to who should make it.

Vice-President Dick Cheney, who headed Mr Bush's energy task-force, had pointed to the oil sands of northern Alberta as a particularly rich prospect. Ralph Klein, Alberta's Conservative provincial premier, promptly rushed to Washington. Visiting the White House, he said that Canada has “energy to burn” and invited Mr Cheney to see for himself the oil sands around Fort McMurray.

Canada is already a big supplier of energy to the United States, to the tune of C$30 billion ($20.2 billion) last year. It provides its neighbour with 9% of its oil needs and 15% of its natural gas. Much more could follow. Boosters claim that Alberta's oil sands contain 300 billion barrels of oil, far more than Saudi Arabia's proven reserves. One producer, a consortium headed by Shell Canada, is talking of enlarging its C$5 billion Athabaska oil-sands project, due to start in late 2002.

Jean Chrétien's federal government finds itself running to keep up with Mr Klein. Ralph Goodale, the minister of natural resources, hurried to say that Americans should realise that other provinces had large energy supplies to sell, including hydro and nuclear energy.

That prompted Ontario's provincial government into brief dreams of increasing supply from its 23 ageing nuclear reactors. Its officials even mused about helping the federal government to sell a reactor to the United States, despite Canada's dismal record of selling only 11 reactors in 40 years, nearly all by offering large subsidies to poorer countries. The goldrush atmosphere also added intensity to an argument between Nova Scotia and Newfoundland over an oil-rich patch of the Atlantic near Sable

Island.

The American demand for energy may have given Mr Chrétien a diplomatic weapon: officials have hinted that the United States's decision to slap duties on imports of Canadian lumber might make energy co-operation more difficult.

But it has fired up the constitutional argument between the provinces, which own and control natural resources, and the federal government, which is responsible for international treaties. At their annual meeting this month, the provincial premiers insisted that they should be included in talks on a North American energy plan. But Mr Chrétien's officials have played down the need for any new masterplan, suggesting that the North American Free-Trade Agreement (NAFTA) was doing the job well. In fact, since May, federal officials have been quietly talking to their American and Mexican counterparts in a three-country working group on energy.

A second dispute has also flared, this one over pipelines. These have long been controversial in Yukon and Northwest Territories. They bring investment, but are said to threaten herds of caribou. Now, if America's Senate follows the House of Representatives in approving a bill to allow drilling in the Arctic National Wildlife Refuge, the two territories would become rivals for a pipeline to transport gas from Alaska to the continental United States—a project described by its backers as “the largest capital spending project in North American history”. A separate pipeline is likely to be proposed for the Mackenzie Valley, after Conoco, an American oil company, last month paid Gulf Canada C$6.7 billion for undeveloped fields in that area.

The Canadian government has deplored the prospect of drilling for gas in caribou calving grounds, but has avoided taking sides. The benefits from satisfying the insatiable American thirst for energy will not come without headaches.

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Cuban politics

Bored by a spy show

Aug 23rd 2001 | HAVANA
From The Economist print edition

Fidel Castro's latest campaign is flagging

LAST year, when Fidel Castro's government organised its succesful public campaign for the return from the United States of Elian Gonzalez, a shipwrecked small boy, Cubans responded with genuine enthusiasm, taking to the streets in large numbers. Many still proudly wear faded “We Saved Elian” T-shirts.

This summer, Mr Castro has launched a similar campaign, this one for the release of five men convicted in Miami in June of spying. Cuban officials say that the five detainees were infiltrating a hardline anti-Castro group in Miami which had previously used violence against Cuba. In the government's view, that makes them patriots who should be sent home at once. To press the point, Mr Castro has addressed huge open-air rallies, and the men's faces appear on the latest batch of government-issue T-shirts and posters. They are also often the subject of night-time discussion programmes on state-run television.

All of this is set to continue until the men are sentenced, in a month or so. But the campaign does not seem to have captured the public imagination in the way that the battle over Elian did. Thousands still turn out for the rallies, but not with visible enthusiasm. A Cuban journalist who recently defected to the United States said that broadcasting officials thought that hardly anyone was watching the television programmes.

Most Cubans, and some people in Miami, would agree that the men were not tried in the most impartial environment. But the five “spies” are not nearly as cute as young Elian, nor as innocent.

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China's economy

Persuading the reluctant spenders

Aug 23rd 2001 | BEIJING
From The Economist print edition

As its exports fall, China is trying to boost its domestic economy

Reuters

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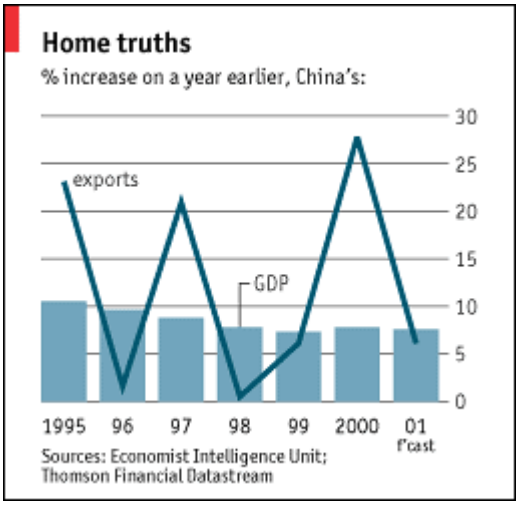
THE figures appear impressive. Officials proclaim that China really has turned the corner after several years of declining growth. Growth is widely predicted to reach 7.5-8% this year. That may be down a fraction from last year's 8%, but it would still be remarkably healthy for a country suffering from a sharp contraction in its export growth as a result of the global slowdown. Indeed, some Chinese economists are predicting that, for the next two or three years, the country will enjoy an unusually stable period of sustained high growth coupled with low inflation.

There is more good news. China's accession to the World Trade Organisation (WTO), likely to happen next year, may bring in another surge of foreign investment, which already is greater than in any other developing country. In the first half of this year, contracted foreign investment soared by nearly 40% compared with the same period a year ago. Officials say China's successful bid to stage the Olympic Games in 2008 will stimulate industries ranging from tourism to construction, adding as much as 0.3 percentage points to China's annual GDP growth.

Government statistics based on surveys of residents in big Chinese cities suggest that consumers are gradually becoming more confident. China desperately needs such confidence. As export growth slows (exports are likely to grow by a mere 5-8% this year, down from nearly 28% last year), domestic demand is becoming all the more crucial. But if there is a “feel good” factor at work, its effects are patchy. On the positive side, retail sales of consumer goods rose by 10.3% in the first six months of this year, slightly higher than the 9.7% growth of last year. But this is only a moderate spending spree by Chinese standards. Nor is China completely out of the deflationary woods. Consumer prices rose by 1.5% in July compared with 0.3% in the whole of last year. But prices of clothing, household appliances, transport and communication continued to drop.

The sell-off of state-owned housing in recent years and large-scale construction of new apartments has encouraged some affluent Chinese to buy homes and spend money on furnishing and decorating. But consumers generally remain cautious about purchases, big or small. Some 70% of urban workers are employed by the state. At a time of civil-service cuts and closures of state enterprises, these people are not eager to spend with abandon.



China's GDP growth figures may look strong, but they are not matched by a corresponding sense of well-being and security among ordinary citizens. A favourite, and reasonable, complaint of urban residents is that an increasingly disproportionate amount of the country's new wealth is lining the pockets of a privileged few. Many are afraid that WTO membership will throw more out of work, particularly in the inefficient state sector.

Even growth of 7-8% is not enough to cope with China's fast-rising unemployment. The urban rate is

officially put at about 3%, but most experts agree it is at least 8%. Rural underemployment is around 30%. This week, the prime minister, Zhu Rongji, said the economy, though still expanding, was in need of a boost. He did not say what the government had in mind, but those close to him indicated that civil servants might be in for a pay rise, there would be easier credit and more incentives for exporters.

In reality, China's growth, though definitely positive, may well be lower than the official figure, given the propensity of local authorities to exaggerate. Moreover, despite GDP growth in the first six months of 7.9%, the increase in the value of industrial production slowed month after month between February and July, from 19% to just over 8% compared with the same months a year ago. Slackening external demand is at least partly to blame.

For the past three or four years, the government has been stimulating domestic demand through massive spending on housing construction and other infrastructure. But this cannot go on forever without incurring unsustainably high debt. Some Chinese economists argue that spending levels will have to be scaled down within a couple of years. The budget deficit is already ballooning. In addition, the government is struggling with the hidden costs of propping up a banking system plagued by bad debts incurred by politically inspired loans to bankrupt state firms.

What then of rural China as an engine of growth? This is where some 70% of Chinese live. Chinese officials realise that maintaining high levels of growth over the long term will depend on the rural market. But in the countryside, the prospects are far from rosy. The average cash incomes of rural households are about the same as they were five years ago, while taxes have been soaring. Membership of the WTO will be a further blow to the farmers as China opens its doors wider to agricultural imports. In the villages, retail sales in the first half of this year rose 7.4%, compared with 11.6% in the cities.

China needs to generate and distribute wealth more effectively, and to keep its labour costs low by letting its rural population find work freely in urban areas. But it remains fearful of what might happen if it scraps Mao-era restrictions on internal migration. Its cities do not have the infrastructure and services to cope with a massive influx of job seekers. The tens of millions of rural dwellers who have found (or are looking for) work in towns and cities are already a huge burden. China is fortunate to enjoy high growth. Even a moderate downturn could cause an employment crisis with far-reaching social and political consequences.

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Tea in China

A scandal brewing

Aug 23rd 2001 | HONG KONG
From The Economist print edition

The fake cuppa

THE best tea in China is said to be grown on the hills around the eastern town of Hangzhou. It is called Longjing, named after the village where it was first grown. The Chinese have been praising Longjing for centuries. Poems have been written about it. It is very expensive. A few leaves, enough to make a small cup, can cost the equivalent of $3.50. However, a shadow has fallen over Longjing tea. Inferior imitations have appeared on the market.

This is serious. It is one thing for the Chinese to fake western goods such as compact discs; but their inestimable tea is another matter. The tea is protected by regulations enacted by the People's Congress of Zhejiang, the province of which Hangzhou is the capital. The authorities have let it be known that transgressors will be severely punished. In a swoop on a Shanghai market, inspectors seized more than 60 samples of various teas, among them Longjing, for examination.

The best quality Longjing is harvested only during a two-week period, usually between April 5th and 21st, after which the weather tends to turn humid. A *sifu*, or tea-leaf master, will lightly roast the leaves to seal their flavour. In brewing the tea the water should be hot, but not too hot. After five minutes, the brew is ready to be sipped accompanied by expressions of bliss of a sort that in the West accompany bottles of over-priced wine. Before this year's harvest, one addict was reported to have secured her Longjing by bidding the equivalent of $1,200 for 50 grammes. In a country where the average pay for a city worker is no more than $1,100 a year, many Chinese were appalled by such extravagance. But think of the fragrance, she said, the delicate taste...

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Corruption in the Philippines

The plots thicken

Aug 23rd 2001 | MANILA
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But which one is believable?

THE leader of military intelligence in the Philippines, Colonel Victor Corpus, claims that Senator Panfilo Lacson, a former national chief of police, has been involved in a plot by drug traffickers to take over the state. In speaking out, the colonel says he is trying to defend democracy. Some of Mr Lacson's fellow senators contend that Colonel Corpus's accusations are meant to undermine democracy, perhaps in preparation for a military takeover.

Whatever the truth, the affair has served to highlight the weakness of democratic institutions in the Philippines in the face of pervasive crime and corruption. Colonel Corpus has accused Mr Lacson of laundering hundreds of millions of dollars in revenues from drug trafficking through accounts in Hong Kong and the United States. Mr Lacson denies these allegations, which were made by Colonel Corpus at a Senate committee hearing.

Although Mr Lacson lost his job as chief of police when his patron, Joseph Estrada, was overthrown as president this year, he still enjoyed enough of a reputation as a good policeman to be elected to the Senate soon after. Colonel Corpus argued that Mr Lacson is a threat to national security, because he stands a chance of being elected president in 2004. The colonel said he feared that Mr Lacson would then submerge the Philippines in “narco-politics”. But his accusations had a hostile reception at the Senate hearing, which began on August 17th. Why was military intelligence, rather than the civilian law-enforcement agencies, investigating a senator? Because, said the colonel, President Gloria Arroyo enlisted the help of military intelligence in fighting serious crime.

Some senators suspect that Colonel Corpus's allegations are part of a smear campaign against possible opponents of Mrs Arroyo in the 2004 presidential election. Senators were further irritated when the colonel accused other members of Congress, as well as judges and members of the media, of corruption. These additional accusations made some senators wonder if Colonel Corpus was the agent of a plot to undermine the institutions of democracy and install a military regime.

A cynical public regards the whole affair as a form of theatre. Many ordinary Filipinos are prepared to believe that the entire establishment is corrupt, and that the balance of power within the ruling elite is preserved only because every member keeps quiet about the wrongdoings of every other member. The competing assertions of Colonel Corpus and his opponents in the Senate that they are protecting the institutions of democracy ring hollow in the ears of ordinary folk. They instinctively know that these institutions have no integrity over and above that of their individual members.

They saw an example of this in January, when the popularly-elected Mr Estrada was overthrown. An Estrada crony upset the balance of power within the elite by publicly exposing corruption within the administration. The institutions of democracy collapsed when the Senate voted to cover up some of the evidence against Mr Estrada and, in response, the generals mutinied and joined tens of thousands of “People Power” protesters.

The Senate inquiry has so far made little progress toward finding out which scenario is the more far-fetched: a Philippines governed by a military clique, or a Philippines governed by drug traffickers. Interestingly, a third possibility is considered so far-fetched that few public figures have bothered to mention it. This is that Mrs Arroyo means to keep her promise to clean up Philippine public life, and is pragmatically employing military intelligence and the media to do it, because the police and judiciary cannot be trusted.

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Australian politics

Message from the outback

Aug 23rd 2001 | SYDNEY
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A setback for John Howard

TO THE rest of Australia, the Northern Territory has always been the last frontier. It is twice the size of France, with a population of fewer than 200,000 that sometimes seems as if it has just stepped out of the pioneering era. In the popular imagination, the territory is a place where people disappear in the searing outback and men prove they're men by wrestling crocodiles. The territory's politics have usually reflected this ethos. In the 23 years since it gained self-government from Canberra, the Northern Territory has been ruled by the conservative Country Liberal Party, whose policies have often ridden roughshod over the aborigines who make up more than a quarter of the territory's population (compared with 2% of Australia's as a whole).

To everyone's surprise, Country Liberal rule came to an abrupt end on August 18th: the Labor Party captured 13 of the territory parliament's 25 seats and prepared to take power in its own right or with support from independents. The Labor leader, Clare Martin, a 49-year-old former broadcaster, signalled a shake-up. The new parliament has a record number of women and aboriginal members, defying the territory's reputation as a male-chauvinist outpost. Ms Martin pledged to abolish the former government's mandatory-sentencing law for theft and property offences, a law criticised by the United Nations because it was seen as aimed at homeless, unemployed aboriginal youths.

But perhaps the biggest shockwaves were felt in Canberra, where the federal conservative coalition government, led by John Howard, is facing an election by December. The Northern Territory's was the third regional election this year in which parties affiliated to the Liberal and National parties in Mr Howard's coalition have suffered losses. The rot for the conservative parties, if that's what it is, started two years ago when a seemingly invincible Liberal government in Victoria, Australia's second-most-populous state, fell to Labor. Earlier this year, Western Australia and Queensland also elected Labor governments. The Western Australia result, like that in the Northern Territory, defied all predictions.

There was a warning for Mr Howard in the way the Country Liberal Party in the Northern Territory urged voters to give their second votes, under Australia's preferential system, to One Nation, an extremist party whose leader, Pauline Hanson, has made waves on the political scene by calling for an end to Asian immigration and to welfare for aborigines. It was an extraordinarily miscalculated tactic designed to lock Labor out by appealing to the territory's prejudices. But it was better suited to the days when Darwin, the capital, was known as a hard-drinking town for misfits. Today it is a vibrant, multicultural city that has become home to thousands of East Timorese and other Asians.

In the event, One Nation gained no seats, and the Country Liberal Party suffered a 9% swing against it. But One Nation will be competing for conservative votes, first or second, in the coming federal election, and Mr Howard is desperately appealing to Liberal Party officials around the country to stay out of Mrs Hanson's orbit. Her party may be only one of his problems. An opinion poll this week put the federal opposition Labor Party ten points ahead of Mr Howard's ruling coalition, enough for a landslide Labor win.

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Nepal's new problem

Here come the Maoist women

Aug 23rd 2001 | KATMANDU
From The Economist print edition

Who want to ban alcohol

THEY call themselves the All Nepal Women's Association: Revolutionary. They want all Nepal's breweries and distilleries to be closed and the sale of alcohol to be banned. This week they showed that they were serious, when some members of the association led an attack on a brewery near the Indian border, burning it down. “The free use of alcohol has done a great injustice to women, as drunken husbands go wild and attack their wives,” says the association's leader, Kalpana Dhamala.

The association is affiliated to the Maoist militant movement that has captured large areas of the countryside, and it seems keen to show that women can be every bit as determined as men. Perhaps more so. Maoist men, like many Nepalese, enjoy a drink. The 48-year-old Maoist co-leader, Baburam Bhattarai, an architect turned revolutionary, has given the impression that the women's demand to ban alcohol is a bit extreme. The fight is against alcoholism, not alcohol itself, he insists.

The government meanwhile has been holding frantic negotiations with the women. Brewing is one of the few successes in Nepal's dismal economy, accounting for 3% of GDP, almost as much as tourism. It employs more than 30,000 people. In an effort to appease the Maoist women, parliament has hurriedly passed legislation designed to regulate sales of alcohol. But as things stand the women remain adamant: ban booze, or else.

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About sponsorship

Religion in Central Asia

Faith in politics

Aug 23rd 2001 | ALMATY
From The Economist print edition

Suspicion about missionaries

AP

Defending Islam with charms, not guns

IT IS something of an annual ritual. At the beginning of summer, hundreds of western missionaries, mostly young American Baptists, flock to Kazakhstan to teach English at local universities for a few weeks, without pay. Many universities, hard up and unable to meet the huge demand for English tuition, gladly accept, looking at it as a beneficial arrangement for both sides.

While it certainly is convenient, it is also controversial. Since the collapse of communism, many people in Kazakhstan and other former Soviet republics have experienced a spiritual vacuum that missionaries have been eager to fill. Although missionaries are still tolerated, local authorities suspect that the line between teaching and proselytising is not always observed. In Kazakhstan about half the population is estimated to be Muslim, and Islam is a jealous faith. Some of its worries may be justified. A few years ago, when the wave of missionaries was at its highest, Baptists offered “Bible aerobics” at an Almaty university. Whatever this was, it wasn't teaching English.

Over the past two years, official attitudes towards religion have become less relaxed. Partly this is because of worries about security. Neighbouring Kirgizstan and Uzbekistan were attacked by Islamic fundamentalists in the summers of 1999 and 2000, leading to concerns that Kazakhstan too might eventually become a target. An expected attack this summer, when the snowy mountain passes become accessible, has so far not happened, possibly because Islamic militants are busy in northern Afghanistan, where this week heavy fighting was reported between Taliban forces and the opposition alliance. But leaders in the region remain on guard for possible attacks by extremists and have strengthened their security forces.

Kazakhstan's parliament is planning to pass amendments to the country's religion law. Vladimir Ivanov, one of the authors of the present law, says that when it came into force in 1992 “we could not foresee the problems we have today with extreme groupings”. One thing it will seek to do is to clarify the status of missionaries.

The changes will not, it is said, affect religious freedom in Kazakhstan. Elsewhere in Central Asia, however, there are concerns about this particular human right. Last week, the United States Commission on International Religious Freedom, a government body, recommended that Turkmenistan be put on the list of “countries of particular concern” for limiting religious freedom to followers of Sunni Islam and the Russian Orthodox church. The Turkmen government has harassed congregations of Baptists, Seventh Day Adventists and Pentecostals. It has shut down or demolished Christian churches, and jailed, beaten and tortured believers.

According to Human Rights Watch, Uzbekistan too should be added to the list of countries of particular concern for religious freedom. The organisation has documented more than 800 cases of religious persecution there since 1999. Most of the victims have been Muslims jailed for long terms for praying in mosques not under the control of the government, or belonging to Islamic groups not registered with the government.

Although Islamic fundamentalism in Central Asia has indeed grown, partly because of authoritarianism in Uzbekistan and widespread poverty generally, the fear of extremism appears to be much larger than the

actual size of the threat. Some Central Asian leaders foster such fears to their advantage.

Pope John Paul is due to visit Kazakhstan for several days starting on September 22nd, his first trip to Central Asia. The country's Roman Catholics are relatively few in number. The majority of Christians follow the teachings of the Russian Orthodox church. But the Roman Catholics, mainly Ukrainian in origin, will no doubt give their leader a good welcome. As the much-travelled pope puts Central Asia, even briefly, on world television, the region's leaders can only look on in envy.

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Lebanon

Divide and rule

Aug 23rd 2001 | BEIRUT
From The Economist print edition

AP

On the point of healing, sectarian hatred breaks out again

AS TEACUP-SIZED countries go, Lebanon is always rather stormy. The arrest last week of more than 200 Christians on vague charges of treason, and the release this week of many of them, may appear to be another brief stir-up. But it has left a particularly bitter taste.

Lebanese politics, in normal times torn by religious and personal rivalries, had lately shown signs of healing. A decade after the country's ruinous civil war, a liberal, pragmatic centre appeared to be emerging at last. Lebanese of all stripes were attracted to its basic ideas: reconciliation between faiths, strengthening the civic freedoms that make the country unique in an autocratic region, and reducing the sway over Lebanon that neighbouring Syria has held for the past quarter-century.

Despite stalling by Syria's allies in Lebanon, most notably President Emile Lahoud, this agenda had been advancing steadily. Earlier this month Cardinal Nasrallah Sfeir, patriarch of the Maronite church, paid a visit to the Druze chieftain, Walid Jumblatt. The frequently bloody animosity between the Druze and the Maronites, who together dominate the country's mountain hinterlands, has been a staple of Lebanese life since the 19th century. The patriarch's unprecedented visit appeared to seal a budding alliance between the sects. At the same time, a dialogue launched between moderate Christian leaders and Hizbollah, the powerful Shia militia that has close ties to Syria, was beginning to bear fruit. Recently too a crushing parliamentary majority passed a bill to curtail the government's powers of arrest and prosecution.

Even Syria seemed to accept that change was in the air. Bowing to growing resentment of its military presence, its government earlier this summer redeployed nearly all its 25,000 troops in Lebanon away from the crowded coastal plain.

Even Syria seemed to accept that change was in the air

Last week's arrests, carried out by Lebanon's Syrian-backed army intelligence service, apparently without the knowledge of the elected government, have interrupted this momentum. A few days later, plain-clothes thugs could be seen beating up relatives who had gathered to protest against the arrests. Then parliament, under intense pressure from Mr Lahoud, the army and Syria, abruptly retracted its bill limiting arbitrary detention.

The charges now being levelled at the remaining detainees read like a classic tactic of divide and rule. Accusing someone of engaging in telephone conversations with Israeli officials may not sound too serious, but relations with Israel are a particularly sensitive issue. No one has forgotten that Christian militias aided and abetted Israel's then minister of defence, Ariel Sharon, in his 1982 invasion of

Lebanon, and that Lebanese Christians massacred as many as 2,000 unarmed Palestinians in the besieged refugee camps of Sabra and Chatila.

Israel's subsequent retreat, and the Christians' later losses to pro-Syrian factions, left the militias chastened. Since then, they have shunned Israel. They may not like Hizbollah's militancy, or the corrupting and humiliating influence of Syria, but Israel's current punishment of the Palestinians and its history of savage reprisals on Lebanese soil have not endeared the Jewish state to Christians, either.

Most Christians scoff at the idea that prominent members of their community, including two well-known journalists, may have spied for Israel. Yet they fear that the mere taint of collaborating with the enemy may revive Muslim suspicions of Christian treachery. As a result, the moderates who have struggled for national reconciliation now worry that their broader agenda is under threat.

As they see it, this is dangerous for several reasons. A decade of massive borrowing for reconstruction has turned Lebanon into the world's most indebted country. Luckily, this burden is cushioned by the substantial wealth of Lebanese emigrés, many of whom are Christians. Reconciliation was seen as the best guarantee of luring back more of their money, and also of stanching the steady flow of emigration. Those hopes have now been postponed.

Similarly, Christian moderates had hoped that dialogue with Hizbollah could lead to a clearer resolution of Lebanon's simmering southern border. The Shiite militia's taunting of Israel over a disputed sliver of land known as Shabaa Farms has kept the issue hot. Now that some Christians stand accused of accepting Israeli money to campaign for “pacifying” the border, it is hard to see Hizbollah softening its position.

Perhaps most painfully for the Christians, the current rumpus may set back their own long, slow process of rehabilitation. Being, in effect, the losers of the civil war, Christians have chafed at the diminished space granted them in what they tend to see as “their” country, and at the privileges that Syrian protection grants their historic foes. In the past year, the Christians seemed at last to have found both the leadership and the tactics to reassert themselves. With these now undermined, the future looks darker.

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Iran

Shuffling the pack

Aug 23rd 2001 | TEHRAN
From The Economist print edition

Muhammad Khatami's new cabinet proves disappointing

ACCORDING to Akbar Alami, a member of Iran's parliament, deal-cutting ministers in President Muhammad Khatami's first reformist cabinet turned the chamber into a parody of Tehran's Friday bazaar. The deputy has been scarcely impressed by the president's new pack, reshuffled since his resounding victory in the elections in June and ratified by Parliament on August 22nd. He thinks it is incapable of running a small town.

Mr Alami is not, as you might expect, a member of Iran's stick-in-the-mud conservative establishment, but a zealous proponent of Mr Khatami's reformist ideas. Perhaps 30% of reformist deputies share his views. Before Wednesday's vote, Mr Khatami used his considerable rhetorical skills to browbeat many of them into giving their vote of confidence to his new cabinet. Nonetheless, many cast their votes sulkily, and some not at all.

On the face of things, Mr Alami and his colleagues have every right to grumble. Back in 1997, when Mr Khatami needed to win approval for his maiden cabinet from a parliament run by conservatives, he still managed to find room in it for Ataollah Mohajerani and Abdollah Nouri, who turned into thrilling exponents of reform. In theory, the president's hands were further freed last year, when reformist candidates won control of parliament. The president, however, views things differently; rather than election triumphs, he remembers the humiliations that befell his first cabinet. A hard-line judge sent Mr Nouri to jail, part of a broader judicial campaign against prominent reformists. Ayatollah Ali Khamenei, the conservative-minded supreme leader, forced Mr Mohajerani to resign. The president has kept his second cabinet short of such risky high-fliers.

That said, the new cabinet is a pale version of the old. A protectionist finance minister has been replaced by a more liberal one, and an unpopular education minister sacked. But newcomers like Morteza Haji, the education minister, and Ali Sufi, the minister for co-operatives, are obscure bureaucrats, known for little save their loyalty to Mr Khatami. Though a self-styled champion of the rights of women, the president did not see fit to make one a minister. Admittedly, his ability to change ministers was circumscribed by Mr Khamenei. But surely he might have given voters more to smile about?

The new cabinet reflects the president's determination to avoid getting bogged down in tiresome confrontations in his second term, as well as his conviction that Iran can evolve peacefully only if some powerful conservatives are lured into the reformist camp—an impossibility if the cabinet contains firebrands. Mr Khatami's commitment to Iran's theocracy is as unquestionable as his commitment to reform; even if it means moving at tortoise pace, he strives above all to drag the system with him. But many reformist deputies are confirmed hares who, unlike Mr Khatami, have to face the voters in 2004. They had hoped to bask in the reflected glory of bold, imaginative government.

It may be that Mr Khatami is a step ahead of his parliament. Trying to race ahead has got deputies, and the cause of reform, nowhere. On numerous occasions, they have unveiled interesting legislation only for the Council of Guardians, a hard-line monitoring body, or even Mr Khamenei, to spike it. Their criticisms of judicial abuses have provoked a fearful reaction. Thirty deputies have been issued with court summonses in the past year; last weekend, a deputy was given a two-year sentence for speaking out of turn. Nor did parliamentarians gain much earlier this month, when they bravely refused to ratify appointments to the Council of Guardians; the supreme leader simply took the matter out of their hands.

Which is the right approach to reform? As an incumbent president with a strong mandate, Mr Khatami retains much of his authority. But as long as the judiciary carries on its campaign against reformers, his hopes of wooing conservatives appear wildly optimistic. Furthermore, it is possible that the whiff of

corruption detected by Mr Alami will convince Iranians that, while Mr Khatami himself is honest, ministers have been waylaid on the path to democracy by old-fashioned enjoyment of power.

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Eritrea

Suddenly, dissent

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From The Economist print edition

After ten years, democracy stirs

THE newspaper sellers in Asmara have never had it so good. They are selling out every day, and selling out of reprints too. In the letters columns, ordinary members of the public are furiously venting their opinions. After ten years of one-party rule under a popular dictator, Eritrea is experiencing its first political crisis.

It is not completely unexpected. Within the ruling elite, arguments had been going on for a while about the record of the government, the future of the country and the conduct of the debilitating war with Ethiopia that ended in June last year. The surprise is how quickly debate and dissent have spread among the general public. Even students at the university, usually an apathetic bunch, have been demonstrating against a summer work programme. Hundreds have been detained, and now their parents are demonstrating to try to get them released.

Criticism of the government began shortly after the armistice was signed with Ethiopia. Eritreans suddenly wanted to know why the war had started at all, why it was not stopped sooner, and why, when it was too late to stop it, the leadership made such a mess of it. From there, they began to dissect the rule of President Issaias Afwerki and the small group who run the ruling party, the People's Front for Democracy and Justice (PFDJ), the post-independence face of the Eritrean liberation movement. In May, 15 members of the party's own central committee signed a letter accusing Mr Afwerki of high-handedness. This month, two of the letter-signers—the fisheries minister and the trade and industry minister—were sacked from their posts. Reformist leaders responded, astonishingly for Eritrea, by going to the press.

Lack of accountability is the chief complaint. The government is still called “transitional”, but looks pretty well entrenched. The president is accused of blocking democracy, and his government of failing to abide by the rules it set itself. The party's vast business interests have never been audited, nor has it paid taxes. On August 10th the chief justice of the Supreme Court was sacked, apparently for criticising the president's office for interfering in the court's operations. Meanwhile, Mr Afwerki keeps in existence the so-called Special Court, which he can use to bypass other legal institutions to charge and sentence individuals, technically for corruption.

The country, however, is unsure how much reform it wants. Mr Afwerki is still popular with many Eritreans, and some say the time is not yet ripe for such a keen debate. The government has shown a certain amount of tolerance: it has not closed down the private press (yet), and elections are scheduled for December, although there are plenty of reasons or excuses why they could be postponed.

Eritrea's aid donors, especially Italy and the United States, are watching closely. They have slightly more leverage than usual, because Eritrea needs all the money it can get, $800m by one estimate, to help rebuild the economy after the war. Eritreans abroad send several hundred million dollars home each year, but there is little investment and still no possibility of trade with Ethiopia, a vital market. In one hopeful sign, an American oil and gas company has gone into partnership with the Eritrean government to explore the northern reaches of the country, where natural gas was found in the 1960s.

The army, about 250,000 strong and yet to be demobilised, is a constant drain on the country's finances. The conscripts themselves are desperate to go home, to the chance of earning more than the $15 a month they have received since they were called up. But the army's top brass, as divided on the question of reform as the country, fears that demobilisation might further inflame the political atmosphere.

Many think the reformists and the president should sit down and talk. There is no sign of that at the

moment, but dissent has now become too loud and broad for the ruling party to ignore it. The truth of the matter is that the war and its aftermath have changed Eritrea, and it cannot be the same politically passive place again.

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Tanzania

The penalty of kindness

Aug 23rd 2001 | KARAGO REFUGEE CAMP, WESTERN TANZANIA
From The Economist print edition

Poor itself, Tanzania plays host to half a million refugees. No easy task

EPA

THE soldiers came at night. Fifteen-year-old Donacie Buchimi heard screams and gunshots, and the next morning his neighbour was lying beheaded in the dirt. Donacie fled, running barefoot through the Burundian rainforest for two days until he stumbled into Tanzania.

He was lucky. Had he fled in the opposite direction, he would have ended up in the Democratic Republic of Congo, a country as war-racked as his own. Tanzania, in contrast, has been peaceful for as long as anyone can remember, and is unusually hospitable to those in need. About half a million refugees from strife in neighbouring Burundi, Congo and Rwanda have found a haven in western Tanzania. New arrivals are politely directed to the nearest UN-funded refugee camp, where they receive food, building materials and a small plot on which to erect a house.

Under the old socialist regime of Julius Nyerere, tens of thousands of fugitives were given five acres each and allowed to settle permanently. Tanzania is a big, lightly-populated country, but the government hesitates to repeat such generosity. Refugees are now required to stay in camps until they can be safely repatriated. In the meantime, they are not officially allowed to go home, for the Tanzanian government does not want Burundian or Congolese rebels to use the camps as bases from which to attack their home countries.

In some ways, the camps are a triumph of charity. The UN Children's Fund (Unicef) goes to great lengths to keep refugee children healthy. Pregnant women are given extra food, including iron and folic acid supplements. Health care is free, and within walking distance. As a result, the proportion of babies born underweight—one of the most accurate indicators of future poor health—has plummeted.

Life in the camps can be dispiriting, however. Dependence on handouts erodes self-respect. Refugees spend hours queuing for maize flour, but there is not much else to do. “Our men are idle here, and it makes them cruel,” laments Angelique Pike, a 42-year-old mother of seven. Ms Pike supplements handouts by trading with local villagers. Her husband does nothing. When she came home late, Ms Pike says, he called her a prostitute and beat her. Such stories are common.

In some areas, refugees outnumber locals by as much as five to one. Everywhere in western Tanzania, the influx has been disruptive. When there is a hiccup in the delivery of food aid, many refugees rob nearby villages. That this has not led to bloodshed is a testament to the mildness of the locals. “We feel sorry for them because their country is at war,” says William Serele, a wizened farmer who lives near a camp. “But they cause trouble. Every Thursday, Saturday and Sunday, on their way back from the market, they enter our homes and steal things.”

The refugees affect the local economy in more subtle ways too. Bored with their monotonous rations, they trade them for bananas and meat. Half a million extra mouths increase demand for almost everything. The more enterprising locals profit from this, ploughing up extra acres to take advantage of soaring food prices, selling cooking pots and clothes in the camps, and even supplying foreign aid workers with chocolate, cheese and satellite-television dishes.

Local subsistence farmers have suffered, however. The prices of maize and beans, their main crops, have plunged because of the free supplies doled out in the camps. The wages they can earn toiling for their neighbours have fallen, because refugees, though officially barred from working outside the camps, do so

in large numbers. Meanwhile, the price of meat, soap, salt, fuel and many other essentials has more than doubled because of demand from the refugees. And locals now have to walk farther to gather firewood; since many refugees cannot afford matches, they keep their fires burning all day.

The UN tries to compensate locals by installing water pumps in their villages and allowing them free access to camp clinics. This helps; but relations between the refugees and their hosts will doubtless remain tricky until the camps are gone.

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The battleground of France

Prime minister versus president

Aug 23rd 2001
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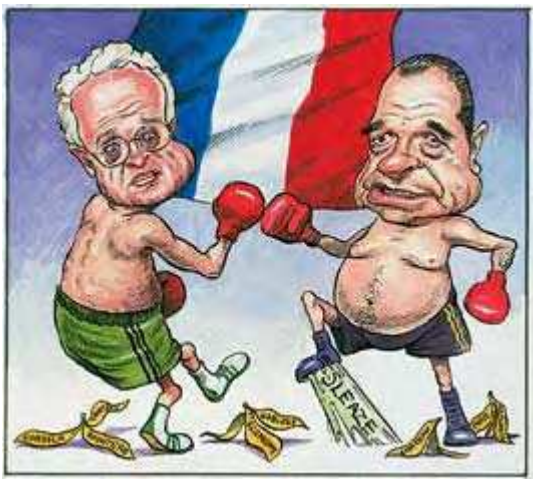

As France's politicians return from holiday, the prime minister, Lionel Jospin (above left), looks as rattled as the president, Jacques Chirac

Get article background

IT SHOULD have been so simple. Lionel Jospin, France's Socialist prime minister for the past four years, would return from holiday and smoothly manage his campaign to unseat the conservative Jacques Chirac in next spring's presidential election. After all, President Chirac is facing a tide of scandal that in most other western democracies would long ago have swept aside the leader, and for most of the past two years the economy has performed well enough to satisfy voters and foreign investors alike.

So why is it now so difficult? As the president prepared for his first post-holiday meeting, on August 23rd, with Mr Jospin and his cabinet, a pro-Chirac newspaper, *Le Figaro*, gleefully noted that the president could "watch his prime minister tying himself in knots."

Indeed so—and none of the knots is easy to untangle. The immediate problem, not least because in the absence of other news it has filled the columns of both the serious and the popular press, is the violence-prone island of Corsica. Mr Jospin is the author of what is known, after his official residence, as the "Matignon process". Due to be voted into law by the end of the year, this aims to soothe Corsicans' separatist feelings first with tax subsidies and encouragement for the teaching of the Corsican language; then, from 2004, and after an appropriate constitutional revision, by giving the island's politicians the right to amend laws made in Paris.

How disappointing, then, for Mr Jospin that a gathering of Corsica's separatist-inclined politicians, most of them supposed supporters of the Matignon process, should in early August have demanded not just an amnesty for some 40-odd "political prisoners" but an end to the manhunt for Yvan Colonna, the suspected assassin two years ago of France's prefect (a quasi-governor) on the island, Claude Erignac. Mr Jospin was forced to take time out from his holiday on the Ile de Ré to assure Erignac's widow that there will "never" be an amnesty for her husband's killer.

That might have calmed the situation—except that only a week ago François Santoni, a former separatist leader who had denounced Corsica's culture of gangsterism, was shot dead as he left a wedding reception in the south of the island. His death was then followed this week by the discovery of two corpses in eastern Corsica, presumed victims again of the separatists' internal feuding.

All of which means that Mr Jospin is suddenly under pressure to defend his plan against accusations, from most of the right and some of the left, that it is not just soft on terrorists but is also unleashing a separatist spirit which, by encouraging the Basques, the Bretons, the Alsatians and others, risks dismembering the republic. No wonder that Jean-Pierre Chevènement, who resigned as Mr Jospin's interior minister last year over the issue and who plans to run against him for the presidency, is asking: “How many assassinations will there have to be before the goal of a sustainable peace in Corsica is seen as a fantasy?” And no wonder Mr Chirac is keeping presidentially aloof, content to let Mr Jospin struggle with this particular knot of his own devising.

The Corsican problem has been intractable for governments over the decades, so the voters, if not his political opponents, may well give Mr Jospin the benefit of the doubt on that score. The same, however, is unlikely to be true in other matters. France's game shots, for example, are almost literally up in arms over the shortening of the period—to conform belatedly with European Union law—in which they can blast away at migrating birds. They want France to seek an exemption from the authorities in Brussels, but Yves Cochet, the Greens' environment minister in Mr Jospin's coalition government, is offering the shooters no sympathy. Should Mr Jospin keep the Greens or the shooters happy? Either way, their votes could be crucial in the presidential election.

But in the end the biggest problem may be the economy. Since Mr Jospin's government came to power four years ago it has won plaudits both at home and abroad. Unemployment has fallen from over 12% of the workforce to under 9%; inflation has been kept low; privatisation has gone pretty well; taxes are down. As the OECD put it last year: “France has not enjoyed such a favourable economic situation for ten years.” And all this despite an electorally popular but economically dubious reduction of the working week from 39 hours to 35—with no loss of pay.

So much for the extended honeymoon. Now Mr Jospin has an economy under strain, with the American slowdown bound to hurt both France and France's trading partners, notably Germany. Predictions by the IMF and others for France's economic growth this year are down from 3.3% to 2.3%, and may go lower still. That, in turn, means a lower-than-expected tax take and so bigger problems in meeting the EU Commission's demand for budget discipline. Meanwhile, consumer confidence has fallen over the past six months to its lowest for two years; unemployment has started edging up for the first time in almost three years; and small firms—those with fewer than 20 employees—are complaining bitterly about the impending cost of the 35-hour week, which will apply to them from January 1st.

The malicious may add an extra complication: Mr Jospin's finance minister is Laurent Fabius, a long-time rival in the Socialist Party and himself a former prime minister. Will he, they muse, be willing to jeopardise his reputation for prudence by letting Mr Jospin keep the voters sweet in the run-up to next year's big election?

But put malice and cynicism aside. Perhaps the real question is whether by the time of the election the voters will simply have become bored with Mr Jospin and all too ready to forget his valiant efforts over the previous five years. As Mr Chirac is happily aware, the French hold their prime ministers, not their presidents, responsible for day-to-day government. In other words, Mr Jospin had better start untying those knots pretty fast.

For his part Mr Chirac had better hope the voters remain relaxed about the growing collection of presidential scandals. So far the allegations attached to his name include the illicit financing of his political party through years of corporate kickbacks when he was mayor of Paris; fictitious jobs for party members, paid for by the taxpayer; and the rigging of electoral lists to ensure a clean sweep of the capital in the local elections of 1989. In addition, Mr Chirac spent over $400,000 in cash from 1992 to 1995 taking himself, his family and his entourage on foreign jaunts. He says the money (undeclared to the taxman) came from secret funds legally acquired as prime minister from 1986 to 1988; others think it may have come from the Parisian kickbacks.

Now it seems that as mayor of Paris Mr Chirac arranged subsidies for a pensioners' charity (of which he was treasurer) which then bought a plot of land to build an old people's home next to Mr Chirac's country chateau. Some 23 years later there is no old people's home—but nor is there the teenagers' holiday camp that Mr Chirac was keen to forestall. One more such scandal and Mr Chirac may yet be in tighter knots than Mr Jospin.

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Macedonia

How many groups, how many guns?

Aug 23rd 2001 | SIPKOVICE
From The Economist print edition

Both of Macedonia's communities are split between hawks and doves

Get article background

ALI AHMETI, the smooth-talking leader of Macedonia's ethnic-Albanian insurgents, has come a long way in the six months since his National Liberation Army (NLA) proclaimed its existence and was instantly denounced by western governments as a marginal group of bandits with whom no decent person could have dealings. This week Mr Ahmeti and his black-uniformed comrades were graciously playing host to senior NATO liaison officers, who swooped in by helicopter to visit them in a school classroom halfway up a mountain in rebel-controlled territory in western Macedonia.

As the negotiators shared chocolate biscuits and fine-tuned the procedure by which NLA fighters would hand over their weapons (or some of them, anyway) to NATO soldiers under a western-brokered peace plan, the atmosphere was businesslike and cordial. Outside, British paratroopers—the advance guard of a NATO force that will eventually number 3,500—chatted to NLA fighters.

But despite the apparently promising tone of these exchanges, it is still far from clear whether NATO can simply relieve some obliging guerrillas of their weapons—a process that is supposed to take only 30 days—and then leave Macedonia to let its people live happily ever after.

As NATO's exhaustive press releases make clear, the intervention force which the allies formally agreed to deploy on August 22nd—after being told a ceasefire was more or less holding—will be drawn from 13 countries, with Britain, France and Italy providing the lion's share and Germany still shaky about what it can do (see next article). But it is much harder to find accurate information about the precise number and character of the local armed factions which the allies may encounter.

The conflict NATO is supposed to be ending has two main protagonists: government forces, led and dominated by the Slav Macedonian majority, against the NLA guerrillas whose declared aim is to secure enhanced political rights for Albanians. To a large extent, the NLA has stolen the show from the ethnic-Albanian political parties which have been pursuing similar aims by constitutional means.

But in the Balkans things are never that simple. There are acute tensions within both of Macedonia's main communities (to say nothing of the small Turkish, Gypsy and Serb minorities). The outcome of these micro-conflicts may well determine whether the broader peace effort works.

In the Slav Macedonian camp, President Boris Trajkovski, a Methodist minister, and his foreign and defence ministers are the main exponents of moderation. They reckon that Macedonia has more to gain from co-operating with the western world. But growing signs of cosiness between the NLA and NATO have enraged many Macedonian Slavs and made them warmer to the more nationalist faction under the aegis of Ljube Boskovski, the interior minister.

If NATO commanders feel nervous about their troops' security, it is mostly because of the hostility they sense from the Boskovski supporters in the VMRO party, which has several ultra-nationalist offshoots. Many of Mr Boskovski's followers—perhaps 10,000 of them, in a country where the regular army is only a

little larger than that—have guns and are ready to use them. They also have money because their party is active in the black economy. They are seething with bitterness towards the whole Albanian community, and they are angry about NATO's apparent tolerance for misdeeds by the rebels—including the killing and expulsion of Slav Macedonian civilians.

Some apparently believe in tit-for-tat retaliation and have acted accordingly. Human-rights workers are convinced that VMRO sympathisers with links to the security forces have already been killing and maltreating Albanian civilians

Conscious of how hard it will be to win the hearts and minds of Macedonia's majority, western governments have launched a propaganda campaign for peace. But it has started badly. An advance team of (mainly British) troops that arrived in Skopje were shielded from the press by junior officers with little training in how to deal with the media—let alone how to smooth the feathers of Macedonia's prickly pro-government journalists.

The private hope of western diplomats is that if the peace plan is seen to work and set Macedonia back on the path of normal economic development, voters will turn away from the VMRO school of nationalism and plump for moderates in elections early next year. But in the short term, more passionate feelings may be rising.

Real armies and fake

On the Albanian side, it is at least clear who speaks for most of the rebels: the hospitable Mr Ahmeti, who, though branded a war criminal by Mr Boskovski, has emerged from the shadows to give press conferences and declare (in language that could have been taken verbatim from speeches by politicians fronting for Northern Ireland's IRA) that “the war is over”.

Unfortunately, the parallel with Ireland does not end there. Just as the “Real IRA” claims to be carrying on the anti-British struggle which the Provisional IRA has halted, the standard of militant Albanian nationalism has been raised by a new force calling itself the Albanian National Army (ANA), which is pledging to fight on—and which claims to have killed several Macedonian soldiers already.

Both NATO and the NLA are reluctant to acknowledge that any such force exists. One conspiracy theory holds that the ANA has been invented by Slav Macedonian diehards to discredit the Albanian cause. Another suggests that Mr Ahmeti and his cronies are keeping the “new” army in reserve as a front behind which they can return to war if their demands are not met.

In between its amicable negotiations with the rebels, NATO is discreetly trying to find out how much weaponry the NLA is taking out of Macedonia for burial or storage. The Macedonian government is insisting that since there are about 7,000 rebels, they must hand over at least 7,000 guns. The precise numbers are still being negotiated. But it would be naive to imagine that all armed Albanians will put all their guns beyond use.

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German troops

NATO yes, Macedonia maybe

Aug 23rd 2001 | BERLIN
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Not all Germans want to send troops to Macedonia

Get article background

AP

Job well done in Kosovo. Macedonia next?

SOLDIERS from Germany have been sent to Bosnia and Kosovo. So why not to Macedonia, and only 500 of them at that? Yet of the 12 countries that have signed up for the NATO arms-collecting mission there, Germany alone is still not sure whether it will be able to honour its pledge. Its government requires parliamentary approval before it can deploy troops abroad. And Chancellor Gerhard Schröder is still not certain he will get it when the Bundestag meets in special session next week.

The debate is no longer over whether German troops, banned from foreign missions for over 50 years after the second world war, should be sent abroad at all. That argument was basically won two years ago when Joschka Fischer, the foreign minister, convinced his formerly solidly pacifist fellow Greens to support the government's decision to send troops to keep the peace in Kosovo. Most Germans now accept, however reluctantly, the government's argument that their re-united and fully sovereign country has to honour its international obligations.

Germany still has its out-and-out pacifists, of course, some on the government's own benches. Earlier this summer, 28 of the 294 Social Democrats in the Bundestag, and seven of the 47 Greens, signed a resolution against sending troops to Macedonia—and the government's majority is only 16. But the real debate over Macedonia is not about the principle, as that over Kosovo was, but about the practicalities: the logistics, and the risks, of getting sucked into a bloody civil war.

In normal circumstances, the opposition Christian Democrats (CDU) might have been expected to back Mr Schröder on the issue. But with only a year before a general election, they are eager to make political capital from his difficulties. Taking up the generals' constant complaints about inadequate funding for Germany's ill-equipped and unwieldy armed forces, Volker Rühe, the CDU defence spokesman, has made his party's support conditional on an extra DM500m a year ($235m) in defence spending. The government has already promised a one-off DM120m plus a further DM15m a month, on top of the DM2 billion a year that it already pays to keep 7,000 German troops in Kosovo and Bosnia. It could offer more.

Yet the CDU, which prides itself on its staunch Atlanticism, is not entirely united. Two of its top men, Wolfgang Schäuble, a former party leader, and Karl Lamers, its foreign-affairs spokesman, have even proposed changing the constitution to let governments in future deploy troops without prior approval. The Bundestag should have the right to block such a step, they argue, but it, not the government, would have to take the initiative. So Mr Schröder will probably get his majority.

That might not end his troubles, however. If, as many fear, NATO finds it necessary to extend its mission beyond the 30-day period it has set itself, he will have to return to the Bundestag to win a new mandate for a probably more dangerous mission—not something he would normally relish in the run-up to a general election.

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Spain's water

Whose water, exactly?

Aug 23rd 2001 | MADRID
From The Economist print edition

The rain falls unevenly in Spain. Spread it, said Madrid—and a storm broke

THE country gets plenty of rain. But it is unevenly spread. So redistribute it. That was the plan announced by Spain's government last year. Yes indeed, said dry regions, though eager to get even more than was on offer. No way, cried well-watered regions, where protesters in huge numbers poured on to the streets. Environment-alists protested too. Opponents are fighting the scheme in regional parliaments, local councils and at the European Union, which can expect to be stung for 30-40% of the construction costs. On August 10th, a group of marchers set off for Brussels from the delta of the river Ebro, one of the areas liable to be most affected.

Spain's last long-term water policy was drawn up in 1933, and the issue has dogged successive governments trying to update it. All agree on the problem, few on how to solve it. Spain's rain does not fall mainly on the plain, nor where most Spaniards live. A third falls on the green strip along the northern coast, home to only one in six of them. Over 60% of the country is semi-arid; parts are at risk of turning into desert. That 60% includes the main tourist areas, with thirsty hotels, golf courses, theme parks and leisure complexes—and some of the best farming areas. Farming guzzles two-thirds of the available supply. And because water is cheap, too much is wasted.

Yet Spain also suffers repeated droughts. So storing rainwater has always been a priority. During Franco's 36 years in power, which ended in 1975, reservoir capacity rose tenfold. The new plan envisages spending about $15 billion until 2008 both to increase the storage and transfer of water and to get it better used. Green critics say the scheme gives too much weight to the first of these aims, too little to the second.

The biggest and most controversial item is the planned transfer of water from the Ebro river, which runs from mountains by the Atlantic coast right across to the Mediterranean. Already about half a cubic kilometre of water is diverted from the Ebro each year in various directions. The government's plan would double this. A fifth of the total would go north toward Catalonia and the big (and thirsty) industrial metropolis of Barcelona; the rest would go south to the parched regions of Valencia, Murcia, and eastern Andalusia.

In its first version the scheme was even grander: its aim was to treble today's transfer. But the government gave way to objections from Jordi Pujol, the regional president of Catalonia, where many would benefit from the scheme but also many oppose it. That won his support. Others fight on. Too many dams and canals, say environmentalists, backed by many Socialist politicians—and look at the money some pals of the government will make building them. What's needed, they say, is more frugal use (aided by realistic water-pricing, add economists), better cleaning-up of effluents and more desalination of sea-water. Environmentalists say the plan would hurt farmers right up the Ebro, besides wetlands and wildlife in its delta.

The conflict is not just about water; it is part of a wider debate between Spain's depopulated interior and the crowded coast. The loudest protests have come from landlocked Aragon, which sees the Ebro water as its only real natural resource, and fears losing it. As it should, says pure economics: farming in such

areas is far less productive and less profitable (even were water priced realistically) than the intensive, year-round irrigation-based growing of flowers, fruit and vegetables in dry but sunny Almeria, in the far south. But since when—ask Californians, West Bankers, Indians—is water an issue just of economics?

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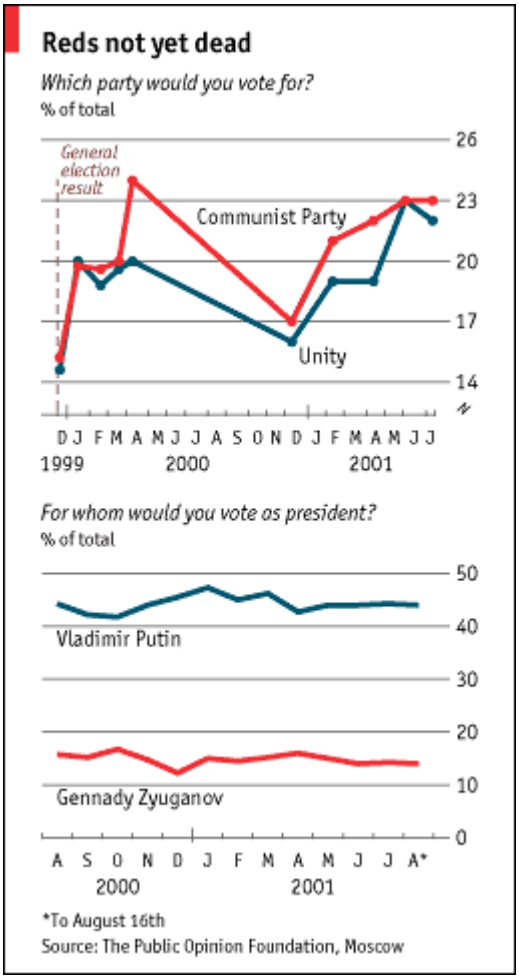
Russia's Communists

Still there

Aug 23rd 2001 | MOSCOW
From The Economist print edition

Lenin's party is once again flexing its wasted muscles

FOR the first 17 months of Vladimir Putin's presidency, the Communists were pretty loyal to the new man. An opposition in name, in fact they barely rocked the government's boat. Now, as Russia marks the passage of ten years since the Soviet Union's demise, they may be making bigger waves to unsettle the new establishment. The Communists want Mr Putin to heave overboard the liberal reformers who managed this summer to force controversial new laws on land, labour and pensions through parliament. And they may start chucking some seaweed at Mr Putin too.



In a doom-laden open letter to mark what the Communists see as a tragic anniversary, the Leninist old guard told Mr Putin to halt his government's reforms. “Patriots” in Russia's secret services should take over the running of the country from “liberal amateurs”. The Communists have also begun to question Mr Putin's ability. And the party's leader, Gennady Zyuganov, called for a nationwide demonstration in October against the imposition of the new code to facilitate the buying and selling of land.

Though such protests have fallen flat in the past, the Communists' demands could strike a chord with a lot of Russians. For many of them, the anniversary of the failed coup that precipitated the Soviet Union's collapse has been an occasion not for savouring the joys of freedom but for mourning the loss of their country's stability and status. Many still bitterly regret the Soviet Union's disintegration. And many fear that the latest Kremlin-sponsored reforms may make them still poorer.

If that were indeed their effect, many older Russians who wanted to give Mr Putin a chance (and who have been grateful that their albeit meagre pensions have been arriving on time) might turn against him. Some may already have started to do so. In the Nizhny Novgorod region, admired by liberals in the 1990s as Russia's “fortress of reform”, Mr Putin's candidate for governor was recently beaten by a Communist. Last week in the Irkutsk region the incumbent governor, another Putin man, was only just re-elected.

Claiming that the tide is going their way, many Communists hint that Mr Putin should acknowledge reality and put some of them into government. The Communists still have the largest single block in the Duma, Russia's lower house of parliament, ahead of Unity, the biggest party that backs Mr Putin; and they still run around 40% of Russia's regions.

On past post-Soviet form, Russia's Communists have been all bark and no bite, not least because they have been scared of losing what influence they have—and because most of their members of parliament and regional governors have been easily bought off by the Kremlin. So their grumbles against the new order may just be hot air expended in the hope of getting a better deal out of Mr Putin. Still, though the Communists have so far failed to turn their potential clout into real power, some of their confidence may be returning.

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Charlemagne

Algirdas Brazauskas

Aug 23rd 2001
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Lithuania's ex-Communist prime minister has plenty of capitalist work to do

HE HELPED his country escape from Soviet captivity. But is he the man to bring it to the promised land? Hopes in Moscow, Washington and Brussels for Lithuania, the biggest but most backward of the three Baltic states, rest on the well-worn shoulders of the country's new prime minister, Algirdas Brazauskas.

As the last leader of Lithuania's Communists, he prodded the evil empire towards collapse. The local party's spectacular breach with Moscow in 1989 crucially loosened the Kremlin's grip over its non-Russian empire. Less than two years later, the Soviet Union fell apart and Lithuania regained an independence that for half a century had seemed almost irretrievable.

Now, as prime minister, his tasks are different. Instead of dodging the steel-teethed men in the Politburo, Mr Brazauskas must steer Lithuania towards the European Union and, with luck, into NATO too. The second matter is largely up to NATO: Lithuania is a bit better prepared than neighbouring Latvia or Estonia, but if the alliance wants any of them, it would probably want all three Baltic states together. The hope for EU membership, however, depends a lot on Mr Brazauskas and his government. Lithuania's delays, especially in making legal and administrative changes, are causing headaches in Brussels.

The Baltic states' geography, which sandwiches them between rich Scandinavia and unpredictable Russia, makes them matter more than their population of 7.4m warrants. Ideally, all three should join together. If Lithuania (with 3.7m people) stays the slowcoach, it will be harder to bring in go-ahead Estonia or vulnerable Latvia, currently the main target of Kremlin ire.

The root of the trouble is wasted time. In the 1990s, while Estonia rushed to privatise, reform and woo foreign investment, Lithuania fiddled, lurching between populism and inactivity. Corruption sprouted under governments of all stripes. Things began to go better in 1999, when, for a few months, a new government set about reform in earnest and balanced the books. But the next government, under a timid and indecisive Liberal prime minister, collapsed this summer, when the main leftist partners walked out and teamed up with Mr Brazauskas's lot.

No one would call the new prime minister timid or indecisive. He exudes solidity, with the beefy self-assurance of a successful Soviet bureaucrat. Though some nationalists dislike his Communist past, most Lithuanians reckon he has amply proved both his patriotism and his democratic credentials. His Social Democrats are not simply rebranded ex-Communists. They followed his risky pro-independence path in 1989. A pro-Kremlin lot have long since vanished. For over a decade, Mr Brazauskas has usually topped Lithuania's popularity polls. Unlike many Lithuanian politicians, he is a good administrator.

To the disappointment of some left-wingers, he shows no sign of bringing a big change of policy. Experienced ministers from the past stay on, at defence and foreign affairs. The new finance minister, Dalia Grybauskaite, is a formidable career civil servant. Breaking off from a hurried confab with her, Mr Brazauskas explains that the problem with the last government was not its general policies but the prime minister's personality. Won't people in the street be disappointed at the lack of changes? “There are a lot of things that people in the street don't understand,” says the former Communist Party boss breezily.

Yet outsiders do have real worries. The biggest is about Lithuania's image abroad. Small countries have to fight for favourable attention; once won, it pays political and economic dividends. Mr Brazauskas knows the ropes: from 1993 to 1998 he was the country's president, a mainly ceremonial job. But he does not speak English. His bluff personal style owes more to the boozy, back-slapping atmosphere of the Soviet bureaucracy than the salon manners of international diplomacy. By contrast, other ex-Communist countries now have youngish, polyglot leaders such as Hungary's Viktor Orban or Estonia's

Mart Laar to schmooze for them at international meetings. Worse still, Lithuania's current president, Valdas Adamkus, a returned émigré from America, is ill and out of touch.

Another worry is the sheer burden of work to be done. The EU negotiations are hard, even for the most go-ahead Central and East European countries. Lithuania needs a huge amount of reform chiefly to speed up the economy and sort out the ponderous and at times corrupt bureaucracy. Mr Brazauskas does not seem the ideal man for that. And at 68 he looks knackered.

Don't slip on the oil

The third worry is balancing the business interests of Russian and western companies, especially in the energy industry. The country's biggest industrial plant (and biggest taxpayer), the Mazeikiai oil refinery, was crippled for years because Lukoil, a Russian company that controls its only supply pipeline, starved it of crude oil, hoping eventually to force out an American investor, Williams, and take it over. But now Williams, with the government's blessing, has teamed up with another big Russian oil company, Yukos, that seems to have made Lukoil release its grip on the pipeline.

That deal, finalised by Mazeikiai's state and private shareholders this week, is a big plus for Mr Brazauskas. But Lithuania must do a lot better at separating politics from big business. The country's new tycoons—often with rich friends in Russia—seem to find it disturbingly easy to buy political influence. And Mr Brazauskas's own reputation as an impartial guardian of the national interest was hurt by an odd escapade early this summer when he flew to Moscow, while still an opposition politician, for secret talks about a gas deal, having first denied that he was planning anything of the sort. Just helping out friends, he says firmly. But will his old pals from Soviet days, now entrenched as owners of much of Lithuania's main industries, have too much clout, both with him and in politics in general?

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Tory leadership

Death Wish 2

Aug 23rd 2001
From The Economist print edition

The Conservative Party leadership contest has turned into a civil war over Britain's relationship with Europe

Get article background

FOR an organisation that has always valued loyalty and good manners above all things, these are strange times. In the week when ballot papers for the leadership contest went out to the members, Lady Thatcher launched an extraordinarily bitter attack on Kenneth Clarke, the Europhile former chancellor of the exchequer. Mr Clarke, one of the candidates for the leadership, was one of those who helped eject her from power in 1990. Declaring her unconditional support for his rival, the Eurosceptic shadow defence secretary Iain Duncan Smith, she described Mr Clarke as “a political has-been” who would be “a disaster” for the party if elected leader.

The next day, Lady Thatcher's chosen successor, John Major, rounded on his old patron. He accused her of having done “immense damage” to his government by encouraging backbenchers to rebel against its European policy. One of those Eurosceptic rebels, he pointed out, was Mr Duncan Smith, who voted “night after night” with the Labour opposition. By contrast, Mr Major praised Mr Clarke as “infinitely the most experienced candidate”.

The leadership election has not caused this bitterness. The poison now coming to the surface has infected the party ever since Lady Thatcher's forced departure. One of her senior cabinet ministers admitted last week that the past decade's worth of sniping had been hellish. “If we continue to treat this leadership election as a continuation of the row over Europe, we will be in opposition for ever,” he says.

Apart from continued feuding, the outcome of the leadership contest is impossible to predict. In every test so far of activist opinion, the small minority which does the work of stuffing envelopes and knocking on doors has backed Mr Duncan Smith. Those people share his right-wing instincts and Eurosceptic views. At the first joint hustings meeting in London on August 22nd, Mr Duncan Smith got rather more cheers than Mr Clarke.

But fewer than 10% of the 310,000 members entitled to vote play any part in their local associations. Even constituency officers don't know who most of them are. They merely send a cheque every year to an organisation which many regard as akin to a social club. The only thing anybody knows about them is that they are old. Patrick Seyd, professor of politics at Sheffield University, found that their average age was 62 when he surveyed them ten years ago. He reckons it could now be nearer 70. Their views remain a mystery, nor do their papers' opinions give a steer. The Tory husbands' rag-cum-bible, the *Daily Telegraph*, is batting for Mr Duncan Smith, but the wives' favourite bible-cum-rag, the *Daily Mail*, has, despite its deep Euroscepticism, opted for Mr Clarke.

Whoever wins will find it impossible to reconcile the differing factions within the party. Lord Tebbit, one of Mr Duncan Smith's most enthusiastic supporters, says: “If you think I am right-wing, check this man out.” Mr Duncan Smith has denied Mr Clarke's claim that he is “a hard-line Eurosceptic” who will manoeuvre for Britain to withdraw from the European Union (EU). He says he would want to “renegotiate” Britain's position in Europe, without explaining what he would do if Britain's European partners refused to renegotiate. But in the past he has been less equivocal. In 1997, he told Parliament: “Poll after poll shows that a growing number of people have determined that outright departure is the

only solution.”

Even if Mr Duncan Smith wanted to distance himself from hard-liners and Eurosceptics, he would find it difficult. Those people will demand the top jobs in his shadow cabinet in return for their support during the leadership contest.

Mr Duncan Smith's tough line on Europe would also make it impossible for the dwindling band of pro-European Tory MPs to serve under him. But they are not the only people who would choose not to work with him. Supporters of Michael Portillo, who was ejected from the leadership race when he failed to secure enough MPs' votes, have made clear that they have no respect for his authoritarian views and his reluctance to move the party to the centre. They include big names in the party such as Francis Maude, the shadow foreign secretary, and Archie Norman, the environment spokesman. That would leave a Tory party led by an inexperienced right-winger, with a shadow cabinet filled with zealots: not a recipe for electoral success.

Although a few will go if Mr Duncan Smith wins, most moderate, “One Nation” Conservatives will stay on. But some are already thinking about the longer term—calculating that the party needs to sink lower still and that another leader must then take over before a real revival can happen.

The outlook if Mr Clarke wins is barely more promising. This week, he was forced to admit that he intended to absent himself from the Commons rather than vote with his party against ratification of the Nice treaty which provides forEU enlargement. Though he has said he would have a majority of Eurosceptics in his cabinet, and he would not force his views on Europe on the party, rows are inevitable and resignations and defections are probable. A substantial minority of Tory MPs would simply refuse to accept the result and continue to wage guerrilla warfare from the backbenches. A meeting in Devon recently of 20 local Tory activists, typical of those going on all over the country, found that nearly half said they would resign if Mr Clarke became leader.

If this civil war continues, the Conservatives are in danger of becoming a fringe party rather than an alternative government. The possibility of a new political landscape is opening up in Britain. Charles Kennedy and the Liberal Democrats are already sensing a historic opportunity to become the main opposition. Tony Blair and the Labour Party can hardly believe their luck. The Tories seem determined to cement Labour in power. Perhaps it's the voters who need to start worrying.

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Policemen and politics

Robocop's revenge

Aug 23rd 2001 | MIDDLESBROUGH
From The Economist print edition

Backstabbing, vicious personal rivalries, allegations of corruption: a perfect background for a career in politics

ON THE eve of the 1997 general election, to illustrate just how New his Labour Party really was, Tony Blair paid a visit to a policeman in Middlesbrough. Ray Mallon —"Robocop" to the tabloid newspapers who lionised him—had been widely credited with importing "zero tolerance" policing from America. Since then, "zero tolerance", once such a popular slogan, has fallen out of favour in Britain—partly because of Mr Mallon's own spectacular fall. Now Robocop may rise again, championing another transatlantic idea, this time as Middlesbrough's mayor.

These days, when he talks about criminals, Mr Mallon stresses the virtues of rehabilitation and compassion. To the residents of Middlesbrough, though, he is the stern detective superintendent who, in 1996, pledged to reduce the town's crime rate by 20% in 18 months, having accomplished a similar feat in neighbouring Hartlepool. He managed it in nine. Critics said Mr Mallon's strategy of cracking down on petty crime and targeting known criminals was confrontational, vindictive and liable to abuse. But residents on Middlesbrough's mean estates ascribe him near-messianic powers, and reverentially recount anecdotes about his pursuit of litter louts and intimidation of thugs.

So when, in December 1997, Mr Mallon was suspended, as part of an investigation into corruption in the Cleveland police force, petitions calling for his reinstatement quickly began to circulate. (Changes in the way crime is counted make it tricky to tell how the criminals responded, but Ashok Kumar, a local MP, claims that the crime rate shot up.) The investigation, "Operation Lancet", levelled hundreds of criminal allegations against dozens of police officers: assaults on suspects, drugs traded for confessions, that sort of thing.

In Mr Mallon's version of the story, he is less Robocop than Mighty Mouse, defending himself against a vast establishment conspiracy, just like Bill Clinton (although that is not, perhaps, the most felicitous analogy). He has, so he claims, been viciously slurred by senior officers and followed by MI5. Charges have been concocted and witnesses suborned. All because of implacable envy, he says, and the momentum that the bogus investigation gathered.

A fair cop?

Of course, even the paranoid are sometimes persecuted. In his pomp, Mr Mallon certainly made enemies, decrying the failures of other policemen and eclipsing his superiors. Despite Operation Lancet's enormous cost and length, it resulted in no criminal charges, and has spawned a messy melée of follow-up inquiries. Mr Kumar agrees that the whole affair has been a deceitful, scandalous vendetta—though Frank Cook, another local MP, is much less sympathetic. Mr Mallon dismisses him as "the political wing of Cleveland police".

Whatever the root cause of this saga—corruption, vindictive personal rivalries, or some combination of the two—it reflects woefully on the police. And after four years, the level of vitriol is undiminished. A still-suspended Mr Mallon is scheduled to face an overdue disciplinary hearing in October (the charges, say his supporters, are wild distortions). Though previously determined to clear his name, he now says he is unlikely to turn up. In any case, he has tendered his resignation: he wants to be free to campaign in a referendum in October, when Middlesbrough will decide whether it wants to have one of the country's first directly elected mayors; if it does, he wants to be it.

But the conspiracies, real or imagined, persist. Mr Mallon and others now allege collusion between the

Labour leader of Middlesbrough council, Ken Walker (who is also chairman of the local police authority), and the chief constable (who refused to accept Mr Mallon's resignation), to keep him out of the race. Mr Walker dismisses such talk as “malicious nonsense”.

And then there was Ray

Despite his better record of delivering on pledges, Mr Mallon sounds a lot like a Blairite politician, and says he might like to stand on a party ticket. Nevertheless, whether or not there is a local plot to thwart his candidacy, the government would probably rather he didn't. When they offered voters the chance to elect their own mayors, ministers expected them to be grateful. Instead, in three of the four local referenda so far held outside London, the public, insofar as it bothered to vote, has declined the offer. Worse, Londoners used their mayoral election to thumb their noses at Tony Blair, by choosing “Red” Ken Livingstone. Though it avowedly wanted mayoral candidates who were diverse and charismatic, it is doubtful that the government had Mr Mallon, with his aura of scandal, in mind.

If they get the chance, Middlesbrough voters may well make Mr Mallon another embarrassing (night) mayor for Tony Blair. As is customary, Mr Mallon says that political ambition has been thrust upon him, and (sounding more like Robocop than he means to) that it is “payback time” for his faithful public. Perhaps his triumph and disgrace have aroused his taste for celebrity. But after all this trauma, running for mayor seems like a masochistic career move. As he will probably discover, there may be more honour among thieves than policemen, but there is even less among politicians.

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Coastal birds

No foul water, no waterfowl

Aug 23rd 2001 | AMBLE, NORTHUMBERLAND
From The Economist print edition

For some, sewage is pollution. For others, it's nutrition

ON THE edge of industrial Middlesbrough lies the largest raw sewage sludge drying plant in the world. Every day Bran Sands squeezes 250,000 tonnes of sewage down to just 75 tonnes of so-called “bio-pellets”. While the cleaned water is piped into the sea, these pellets are used as fertilisers or as a fuel. But what does it mean for the Norwegian purple sandpiper?

For people, sea is better without sewage. For birds, that is not necessarily the case. Britain's shores are home to a wide range of birds, many of which thrive on molluscs and worms which, in turn, have for years lived happily off the hundreds of tonnes of sewage poured daily into coastal waters. But now the European superstate is forcing Britain to remove this nutritious material from its shoreline, and scientists fear that the birds may suffer.

The clean-up is the result of the European Union's stringent Urban Waste Water Treatment Directive, which is being implemented enthusiastically in Northumberland, at least. “Never in the history of waste water treatment in Britain has so much been done to clean up discharges in so many places over such a short time,” says Chris Spray, Northumbrian Water's environment director.

Scientists commissioned by Northumbrian Water are now monitoring an estuary at Amble, Northumberland, to find out if numbers of birds are in decline. “Something like a third of the organic particles at Amble have their origin from sewage discharges,” says Peter Evans, a conservation biologist at the University of Durham. “We can expect some notable effects when these are removed.” Mr Evans fears for the purple sandpipers which migrate to Amble, particularly the smaller variety from Norway, which would be the first to feel the pinch if food supplies ran thin. The British Trust for Ornithology is studying the question around the country: early results suggest that lots of waterfowl are indeed living off pollution.

Down at the beach, it's certainly harder to spot the birds. Now that Amble has a smart new purifying works, the gulls no longer circle over the end of the underwater sewage pipe. Nobody knows whether the birds on nearby Coquet Island, which include the roseate tern, an endangered species in Europe, will survive. On the Firth of Forth, says Northumbrian Water's Mr Spray, large populations of scaup, a diving duck, vanished after the effluent was cleaned up.

The European Commission, however, is unflappable. “It's true that a rubbish tip will provide conditions that will be attractive to some birds, but those conditions are artificial,” sniffs a spokesman. Birds that live off turds are evidently not a matter of great concern.

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House prices

Debt trap ahead

Aug 23rd 2001
From The Economist print edition

The housing market is booming because mortgages appear cheap, but debt will take longer to pay off

THE economy continues to do the splits. Growth in the second quarter slowed to its lowest rate for two-and-a-half years. With manufacturing in recession, that dismal performance would have been even worse but for Britain's shoppers. While exports slumped in their biggest decline for a decade, consumer spending rose at an annual rate of almost 5%.

That traditional engine of consumption, a buoyant housing market, is pumping away again. When property values are rising, more people tend to move, which in itself generates the need for new purchases. Even if they stay put, some of the extra housing wealth leaks out into higher consumer spending.

Total mortgage lending jumped in July to a new record of £15.5 billion, nearly half as much again as a year earlier. On August 20th, the Council of Mortgage Lenders more than doubled its forecast for house price inflation in the year to the fourth quarter of 2001 to 11%. In April, it was expecting a rise of 5%.

Once again, the property market is fulfilling the dreams of Britain's homeowners. Not only do they acquire somewhere to live, they also become effortlessly rich. No wonder that housing looks an increasingly attractive way to save in comparison with pensions which have been hit by falling financial returns and annuity rates. In contrast, for decades property has proved itself to be a safe way for people to build up capital.

Not only that, homebuyers are finding that they can take out big mortgages in relation to their income and not find themselves over-burdened by high interest payments. The latest surge in house-price inflation has been spurred by the lowest mortgage rates for 40 years. The cost of servicing mortgage debt is beguilingly low compared with previous property booms.

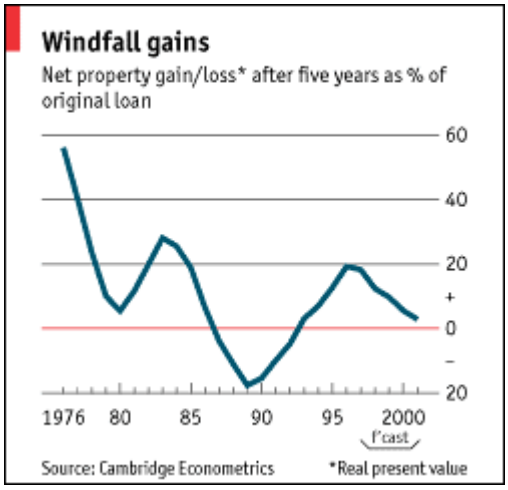
If it all sounds too good to be true, it is. In the short term, new borrowers undoubtedly gain from the lower cost of servicing debt. But in the longer term, they lose compared with an earlier generation of homebuyers. That's because debt will be eroded far more slowly than used to be the case.

The shift to a low inflation economy is primarily responsible. When inflation was high, so too were initial borrowing costs. But high inflation also whittled away the real burden of mortgage debt, allowing buyers to make big gains within only a few years of purchasing a house. With inflation now so subdued, debt has to be repaid in real money.

Buying a home was most lucrative in the 1970s when inflation was rampant. A typical first-time buyer in 1976 made real gains—the increase in the value of the house less the total cost of servicing the loan—worth more than half the original loan within five years (see chart). But as inflation has subsided, so these gains have fallen. A typical first-time buyer in 1996 has made gains over five years worth less than a fifth of the mortgage loan.

The outlook is even less promising, according to Cambridge Econometrics. With inflation assumed to remain at the government's target of 2.5% over the next five years, it expects gains to relapse to just 3% of the loan taken out by a first-time buyer this year.

That calculation assumes a period of stagnation in the housing market rather than an outright bust. However, the forecasting group believes that house prices have already risen too high in London and the south-east in relation to average household income in these regions. Saxon Brettell, a director of Cambridge Econometrics, warns that “this increasingly looks like a speculative bubble in London and the south”. The longer this continues, the more likely it is that prices will subsequently have to fall.



Such warnings about the London property market may be over-pessimistic. The Council of Mortgage Lenders concurs that there are relatively more overstretched house-purchasers in the capital than in the rest of the country. Yet the council's own figures for price-to-income ratios, which take into account the total household income of people in the process of buying houses, suggest that high London prices are explained largely by high London incomes. In any case, there are a number of special factors at work in the capital, notably the relative youthfulness of its workforce and, thanks in part to high levels of immigration, the current rapid growth in London's population after half a century of decline.

However, the main point of concern remains. Household debt now stands at a record high in relation to disposable income. In a low-inflation economy this debt has to be repaid in honest currency. Borrowers can no longer rely upon inflation to do the heavy lifting for them.

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More industrial decline

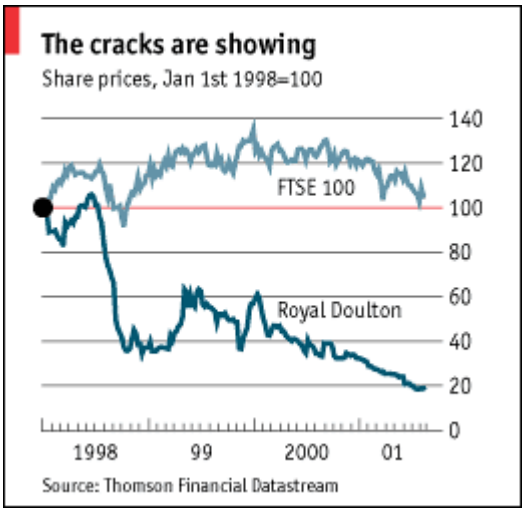
The china syndrome

Aug 23rd 2001 | STOKE-ON-TRENT
From The Economist print edition

Ceramics companies are suffering because of their failure to notice how people's lives have changed

"SEE china in a day" runs the advertising slogan to attract tourists to the potteries at Stoke-on-Trent in England's West Midlands. Industrial pottery, started by Josiah Wedgwood, was at the forefront of the industrial revolution. Stoke is still the centre of the industry, but some of its big names are now struggling. Royal Doulton is in the most serious difficulties. Cheap imports and a strong pound have done their bit, but much of the pain has been self-inflicted.

Royal Doulton employs about 3,000 people in its factories in Stoke, but despite a four-year "recovery plan" the company has been losing money for the past three years. Last year it made an operating loss of £14.7m. The shares have fallen to a fifth of their value in 1998 (see chart). On August 23rd it announced a half-yearly loss of £9m. Its factories are now on a four-day week.



The most famous name in the business, Wedgwood, now part of the Waterford Wedgwood Group, had been doing better than Royal Doulton. But its factories have been laying off workers, and they closed for 18 days over the summer. Wedgwood is now on a four-day week for six weeks. Portmeirion, a medium-size company, has just lost its managing director after making an operating profit of just £17,000 over the past half-year.

Royal Doulton has attracted the attention of Alchemy Partners, the private equity business headed by Jon Moulton that tried to buy Rover cars last year. Alchemy, which admits to preliminary talks, says that a deal is "a million miles away". Alchemy's interest in an ailing ceramics business reflects broad agreement amongst observers of the industry as to where Doulton went wrong, and how profits can still be made.

The British ceramics market is worth about £750m. Most domestic producers have seen their market share fall over the past ten years as cheap imports, mainly from the Far East and Europe, have risen sharply to 25% of the market. But firms like Royal Doulton have also misjudged the trends in the ceramics market. The most important of these is the rise of "casual dining", as it is known in the trade.

Over the past 20 years, consumers have abandoned the set-piece family dinner in favour of TV dinners, casual meals or eating out. Rather than buying the matching china sets that used to sustain Wedgwood and Royal Doulton, many consumers now prefer to buy individual pieces. Kevin Farrell, chief executive of the British Ceramic Confederation (BCC), says that the industry has never been good at finding out what its customers want. Announcing its half-yearly results, Royal Doulton admitted to "weaknesses in its information systems" in the past which meant it had never had a clear idea of what sold well. These had now been rectified. "About time, too," says Geoffrey Snow, an analyst with Pope's, a stockbroker in Stoke.

The people who have done well out of the trend towards casual dining have been the craft potters. According to the journal *Ceramics in Society*, the numbers working in the ceramics industry are now almost matched by the numbers making a living from craft pottery. The craft potters are benefiting from the growing demand for individual, expensive pieces, which Moorcroft, another Stoke-based company, has cashed in on. It is making a 10% profit on its art nouveau-style vases and dishes.

But, more appropriately for Alchemy, industrial pottery businesses, which churn out cheap stuff for the catering trade, have also been able to profit from these trends. Steelite—which Royal Doulton sold in the early 1980s—is the most successful, making an estimated 10% profit on a turnover of £36m. With the increase in eating out and leisure spending, the restaurant, hotel and tourist industries have grown rapidly. Steelite's new managers have specialised in making strong, cheap crockery for the catering business. According to the BCC, this sector has increased in value tenfold over the past two decades.

Royal Doulton's failings are on display at its shop in Stoke, in a jumble of timeworn ranges from glassware to tableware, from intricate porcelain figures to mighty commemorative Toby jugs. The company's designs are outdated, and its strategy flawed. It has made no effort to get into either of the two growing sectors in the industry, industrial pottery or the smaller but lucrative market of “arts pottery”. There is still money to be made in ceramics, but not the way Royal Doulton is going about it.

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Conservation

Wash and gone

Aug 23rd 2001 | EDINBURGH
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The wrong sort of cleaning has damaged many historic buildings

BACK in the 1970s, when heavy industry went into decline and the smog disappeared from Britain's cities, it seemed like a good idea to clean all those soot-blackened buildings. For some it worked, but for others, it looks like turning out to have been an expensive mistake.

Britain took to cleaning its buildings after Paris set the fashion in the 1960s. Getting rid of a century of grime gave the cities an air of youth and energy, which went down well with civic leaders struggling to reverse urban decline.

London, with its miles of white Portland stone, was a suitable case for treatment. Limestone, provided it is not sand-blasted, cleans rather nicely. A wash down can leave a protective coating which helps to keep stonework in good nick for years to come. But other materials, particularly sandstone, can take badly to cleaning.

Unfortunately, a lot of contractors steamed in without really knowing what they were doing. Grit-blasting usually takes off original texture and detail as well as grime which often, funnily enough, protects the stone underneath. It can change the colour of buildings. Several terracotta brick buildings in Manchester, once a deep red, are now a rather nasty pink.

Worse still, strong chemicals, including acids, were often used. These can accelerate decay. “You can get 200 years-worth of erosion happening in 20 years,” says Ingval Maxwell, conservation director of Historic Scotland, a government agency.

The problem appears to be worst in Scotland, particularly in Glasgow, where millions of taxpayers' pounds were spent subsidising stone-cleaning as part of the city's post-industrial renaissance. Miles of sandstone facades are now quietly rotting away, sometimes noisily so when bits of masonry fall off. “I fear an enormous repair bill is coming over the horizon,” says Mr Maxwell.

In England, Stockport Council is now spending £300,000 on cleaning and restoring the town hall. Stonework on the building was damaged by a 1977 sand-blasting which, while it turned a black building white, also took off the limestone's protective facing, swiftly turning it grey again.

Clean-up know-how has advanced a long way, says Mike Bullen of Maysand, a Manchester stonework firm. He is just using brushes and water on Stockport town hall. But in some cases, stonework is best left alone. After a big row a few years ago, Historic Scotland stopped Edinburgh Council from cleaning the Scott Monument, a city centre landmark which remains dirty but undamaged.

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Peace process

A yes, at last

Aug 23rd 2001
From The Economist print edition

Moderate nationalists have approved reforms to Northern Ireland's police

Get article background

AP

Getting behind the reforms

THE Union flag flies over police stations in Northern Ireland. Even the name of the Royal Ulster Constabulary is an offence to nationalists. Some 93% of the force is Protestant. When the body charged with enforcing the law is seen by one side as the property of the other, it is not surprising that Catholic discontent over the origins and nature of the RUC has played such a large part in Northern Ireland's troubles, nor that reform of the police should be so central to the peace process. That is why the decision by the moderate nationalist Social Democratic and Labour Party (SDLP) to support the reforms of the RUC proposed by the British and Irish governments was greeted with such relief in London and Dublin.

The peace process has focused primarily on two issues—decommissioning weapons and reforming the police. Unless all parties to the peace process can agree on those two issues, it will fail. Decommissioning has got nowhere, with a recent IRA offer to lay down its weapons then swiftly withdrawn, before its vague promises had barely even been read. Police reform, by contrast, may at last be getting somewhere.

The original blueprint for reforming the RUC came from a commission set up as a result of the 1998 Good Friday Agreement, headed by a former Conservative Party chairman, now the EU's commissioner for external relations, Chris Patten.

The hearings of the policing reform commission were often stormy. Maurice Hayes, the only Northern Irish Catholic on the commission, wrote later that it heard diametrically opposed views of the RUC: “one lot wanted us to canonise them, the others to castrate them”. When the commission reported, unionists opposed its proposals; the former Northern Ireland secretary of state, Peter Mandelson, then amended them to try to placate the unionists; his emendations have since been amended to placate nationalists.

That accounts for the odd state of affairs that now prevails. The Catholic Church, which has never publicly supported anything to do with the RUC before, has backed the plan. John Hume, the SDLP leader, has called for Catholics to join the RUC and has said that the SDLP will now nominate representatives to the new Policing Board. Unionist politicians, meanwhile, are glum and non-committal, even though the deadline for nominations to the Policing Board has now passed.

Still, deadlines tend to be flexible affairs in Northern Ireland's peace process, and the betting is that both the larger Ulster Unionists, led by David Trimble, and the Reverend Ian Paisley's Democratic Unionists will eventually sign up. Since Northern Ireland was created, unionists have criticised nationalists for boycotting the police. It is inconceivable that unionists will start to boycott the RUC themselves.

But while the SDLP's backing for the reforms takes the debate on policing one step forward, Sinn Fein, the IRA's political wing, is refusing to endorse them. Sinn Fein has linked support for the reforms on policing to decommissioning; and while an agreement on decommissioning remains beyond reach, Sinn Fein is unlikely to back the policing proposals.

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Employee loyalty

An alternative to cocker spaniels

Aug 23rd 2001
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The idea that loyalty pays is being severely tested by the economic downturn

OVER the past few years, much has been made of the value to companies of loyalty—the loyalty of customers, suppliers and employees. The high priest of the loyalty cult is Frederick Reichheld, a director at Bain & Company, a consultancy firm, and author of “The Loyalty Effect”, a 1996 bestseller which argued that engendering loyalty makes sound economic sense. “Business loyalty,” said Mr Reichheld, “was considered an oxymoron not so long ago.” Crude downsizing in the early 1990s crushed the loyalty of millions. “You want loyalty?” asks the ruthless bond trader in Michael Lewis's “Liar's Poker”. “Then get a cocker spaniel.”

The economic benefits of employee loyalty are real enough. They include lower recruitment and training costs, the higher productivity of experienced workers, and the positive effect that such workers have on customers and future employees. In the present economic downturn, some companies are trying to hang on to these benefits at the same time as they trim their labour costs.

For example, Accenture, a large consultancy, has introduced a scheme for its staff called FlexLeave. This enables them to receive 20% of their salary, plus their employer-provided benefits, while they take a 6-12 month sabbatical. In effect, the company has bought a call option on their services. Come the upturn, they will be available to return to the fold. Accenture says the scheme, introduced in America in June, “was extremely well received”. It is now being extended to Europe and Asia.

Siemens, a German electronics giant, is to introduce a similar scheme on September 1st. Employees in Munich and Berlin who work for its mobile-communications division (which lost *euro*511m—$446m—in the three months to June) will be able to apply for leave of between three months (on 50% of pay) and 12 months (on 20%). The company thinks that the lean times will not last. Although Germany has high unemployment, skilled labour is scarce and Siemens does not want to lose it altogether. The “war for talent” continues, albeit on a narrower front.

Other companies have a bigger challenge: to retain the benefits of loyalty at the same time as they lay people off. There are two risks here. One is what has been termed “layoff survivor syndrome”, the tendency of those who remain to be demotivated by anxiety, guilt and an extra workload. The other is of ex-employees bad-mouthing the company about how they have been treated. “Crass firings harm an employer's reputation and ability to attract the best employees,” says Richard Bayer, chief operating officer of The Five O'Clock Club, a New York-based career-counselling network.

How does a company retain the benefits of employee loyalty while simultaneously laying people off?

Cisco Systems, one of Mr Reichheld's model loyalty-builders, recently introduced a novel scheme that attempts to minimise both risks. It has offered those people it laid off this year at its Californian headquarters the option to work for a year for a charity linked to the company, and to be paid a third of their salary plus options and bonuses. This eases the burden of redundancy and gives a “caring” signal to the employees who remain.

Once upon a time in Japan

Not long ago, western firms would have turned to Japan for advice about how to foster loyalty. Companies there were thought to have an inside track on the subject. The Japanese “salaryman” traded loyalty, punishing hours and obedience for lifetime employment and security, and everybody benefited.

But the idea was always something of a myth. The “lifetime” security lasted for little more than 30 years (most salarymen retired on a negligible pension at 57), and it applied only in the biggest companies, representing probably no more than one-third of the workforce. The rest of the labour market was scarcely more loyal than a Wall Street bond trader.

Carlos Ghosn, the Renault executive sent in to save Nissan, undermined what remained of Japanese-style loyalty when he announced in 1999 that 21,000 of the car maker's employees would have to go and five domestic factories would be shut for good. Other large Japanese companies followed his example and they are now painfully (if belatedly) also downsizing. This week Fujitsu announced that it will cut its global workforce by 16,400, or 9%, by next March (see table).

Although many of these cuts have been designed to minimise job losses inside Japan (and maximise those elsewhere), loyalty is fast going out of fashion among Japanese youth. They see the pact that their fathers made as lifetime slavery; increasingly they prefer to work part-time or as temps.

Going, going

Selected job cuts announced this year

Lucent Technologies	34,000-39,000
DaimlerChrysler	26,000
Fujitsu	16,400
ABB	12,000
Philips	11,000
Isuzu Motors	9,900
Procter & Gamble	9,600
American Express	5,600-6,600
Ford	5,000
Citigroup	4,700

Sources: Reuters; *The Economist*

Mr Reichheld is now offering what Japan cannot: a guide on how to engender loyalty. He has a new book out this month (“Loyalty Rules”) and an article in the latest issue of the *Harvard Business Review* in which he argues that loyalty stars (such as Harley-Davidson, Enterprise Rent-A-Car and the MBNA credit-card organisation) have certain features in common. One of the less obvious is that they tend to be organised in smaller teams than their less successful rivals.

The value of small teams is something that military folk have long been aware of, and it may be no coincidence that Charles Cawley, president of MBNA, is an ex-marine. Mr Reichheld says that the ideal team size for companies is between five and ten, depending on the industry.

The loyalty stars also tend to have selfless leaders who communicate clearly that loyalty matters. Communication of such messages is being made easier by the development of in-house corporate Intranets (see article). Leadership, though, still seems to be disporportionately rewarding. This week an annual survey by PricewaterhouseCoopers, a large accounting firm, showed that the bosses of the biggest British companies saw their total earnings rise last year by 16.7% while average earnings went up by only 5.9%. Disparities like that eat up loyalty like a computer virus.

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Ford's internal communications

Inside out

Aug 23rd 2001
From The Economist print edition

One e-business is still growing

DOTCOMS may be moribund, but inside companies, the Internet is still finding cost-saving new uses. “B2E—business-to-employee—didn't have a crash,” says Bipin Patel, in charge of developing the potential of the corporate intranet at the Ford Motor Company. “It's still growing.”

Ford has gone further than most companies to get its employees online: it offered its American employees personal computers, and 90% of them accepted. Ford hopes that the free PCs will save its own and its employees' time by moving services online. General Motors, Ford's great rival, considered a similar scheme but found that most employees willing to use PCs already had them. It is helping staff to pay for high-bandwidth connections instead.

At Ford, the human-resources department has pioneered a scheme to provide up-to-the-minute information to employees about pay and benefits. In the past, employees sometimes found that it took weeks to get a copy of the pay information they needed to do their tax returns, and the department's staff spent mind-numbing hours answering the same questions from hundreds of different employees. Now employees can look at a password-protected site that displays their payslips over the previous 18 months. They can see all deductions, and the hours they worked. All this information was on the human-resources database: displaying it to employees has saved staff time.

“People want more and more of this self-service information, which they can manage themselves,” observes Mr Patel. “There is no such thing as information overload here, because it's their information.” Even training seems to work better online: Ford employees can now download a range of courses, including one on “Listening and Handling Tough Situations”, all designed for digestion in ten- or 15-minute gobbets. The company claims to have cut training costs by $2m during the past six months, as fewer people leave their desks to learn.

The company also uses its intranet to communicate with its staff around the world. Jacques Nasser, Ford's boss, sends out “Let's chat” notes once a week. In fact, Mr Nasser does most of the chatting. He gets hundreds of e-mails in reply, but the communication is basically a one-way flow. The company also runs chatrooms, in which employees can question various inhouse experts and outside analysts live on the corporate intranet.

In time, thinks Mr Patel, communications technology will reshape corporate behaviour. It will encourage collaboration and team-working. Already, the Internet is causing disintermediation within companies, he argues, just as it did in e-commerce: the human-resources department does much less administration once the benefits system is more self-service, but rather more advising and consulting. One day, working in human resources might even be fun.

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German business culture

Broken mould-breakers

Aug 23rd 2001 | FRANKFURT
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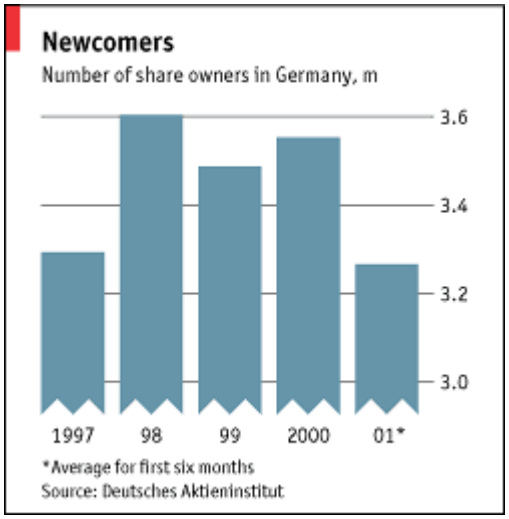
Problems at Deutsche Telekom, Neuer Markt and Mannesmann

HOW about these for three symbols of the changes in German capitalism in the past few years? First, the eagerness with which small shareholders, 3m of them, snapped up shares in Deutsche Telekom, the former state-owned telecoms monopoly. Second, the rise of the Neuer Markt, Frankfurt's market for "growth" stocks. And third, last year's stunning takeover of Mannesmann, a telecoms and engineering firm and a grand old name of German business, by Britain's Vodafone.

How quickly, at least for small shareholders, the dream that these three symbolised has turned sour. The price of shares in Deutsche Telekom, a third tranche of which was sold a year ago for *euro*66.50 ($63.90), dipped below *euro*17 this week, a mere *euro*2-odd more than the price of the first initial public offering in 1996. The shares are still reeling from a huge surprise sale, managed by Deutsche Bank, of shares that had been used to buy VoiceStream, an American telecoms firm. Soon Deutsche Telekom faces two more hurdles: its first-half results are due out on August 28th; and on September 1st a lock-up on further sales by ex-VoiceStreamers expires.

The Neuer Markt, meanwhile, has lost almost 90% of its value since its peak last spring, and these days has the reputation of a spivs' playground. This week its Nemax-50 index dipped to within 30 points of the 1,000 mark. Recently the Deutsche Börse, which runs the exchange, has tried to tighten the rules, for example by throwing out companies whose shares are consistently worth less than one euro. However, that has been delayed by a court ruling in favour of an affected company.



This week's star turn, though, has been Mannesmann. Five months ago a prosecutor in Dusseldorf said that he was investigating a DM60m ($28m) pay-off to Klaus Esser, Mannesmann's boss: had the prospect of such a large sum influenced Mr Esser's capitulation to Vodafone? This week, just before Mannesmann's annual shareholders' meeting, it emerged that the prosecutor is also interested in members of the company's supervisory board.

No small fry, either: Klaus Zwickel, head of Germany's biggest trade union, IG Metall; Josef Ackermann, earmarked as the next boss of Deutsche Bank; and Vodafone's chief executive, Sir Christopher Gent. Apart from Mr Esser's money, at issue is the approval of payoffs worth DM100m, most of which went to past members of Mannesmann's top brass. No case to answer, say the chaps on the supervisory board. Sir Christopher said so to the shareholders; Mr Esser defended himself testily in a German business magazine. Nonetheless, small shareholders' representatives were hopping mad.

Part of the problem is that different actors in German capitalism are changing their behaviour at different speeds. Although it infuriated Deutsche Telekom's bosses and shareholders, Deutsche Bank's bumper share sale was more a sign of its ambitions as a global investment bank, rather than a mark of old-style German relationship banking. That said, the clumsy execution showed how much Deutsche Bank still has to learn, and it was a public-relations disaster. The Mannesmann payoffs were triggered by an Anglo-Saxon takeover which shareholders accepted, but they were the product of German corporate governance, which is ripe for reform.

But will the bad press turn Germans away from shares altogether? So far it has not. In the first half of this year, says Rüdiger von Rosen of the Deutsches Aktieninstitut, which promotes share ownership, the

number of direct shareholders did fall a little. Remarkably, however, the number owning via mutual funds rose by more than 1m. A sign of maturity, that Germans are trusting fund managers to build up their pensions, rather than betting on risky individual shares? Maybe, says Mr von Rosen, but he is cautious: “It's a crucial situation,” he says.

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Telephones in the Maldives

Beached

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Another peril for paradise

COMPETITION is what every government is supposed to introduce into telecommunications these days. But what do you do if you have a mere 275,000 people—roughly the population of Newark, New Jersey? And what if that tiny population is scattered across 30,000 square kilometres (11,000 square miles), only 1% of which is above water? For the Maldives, a group of coral atolls in the Indian Ocean, linked by small boats and the world's second-largest fleet of Twin-Otter seaplanes, competition looks a rather different issue than it might do in New Jersey.

Last week, the Maldives government published a policy document, making the sort of noises about promoting competition that the World Bank and World Trade Organisation expect to hear these days. At present, the Maldives has only one telephone company: Dhiraagu, jointly owned by the government and Britain's Cable & Wireless. Two years ago, the company finished the task of connecting the country's 200-or-so inhabited islands to the fixed-line network. Now the government wants it to connect all the islands to a new mobile-phone network.

Creating the fixed-line network was hard. Most islands have only three or four such telephones, connected wirelessly to the network by digital microwave links. That creates difficulties. The masts are eyesores: the tallest structures on most islands, they jut up through the coconut and palm trees. To work, microwave requires a line of sight between masts—but the curvature of the earth sometimes makes that impossible. And operational costs are high: the towers have to be galvanised, to protect them from the corrosive sea air, and a boatload of fuel for the generator must be delivered each week.

Less than two years ago, Dhiraagu launched a digital mobile network. Already, it has more than 10,000 customers. At the end of August, it will launch prepaid mobile-phone cards. That could double mobile customer numbers within a year.

The company has a growing business carrying calls from the 500,000 or so visitors, mostly Italian, British and German, who come each year to frolic on the country's white beaches or scuba dive off its coral reefs. There are often more than 4,000 “roaming” customers on the network, a lot compared with the country's 16,000-odd hotel beds. Somehow, there is nothing like sitting under a palm tree, piña colada in hand, to make people want to ring the office and boast about it.

But boasting does not come cheap. Although several of the world's fibre-optic cables sweep past the Maldives, a connection to them would cost the tiny country an unaffordable $40m. So international calls go by satellite, and cost between $1.20 and $3.50 a minute. High international charges tend to subsidise local call costs of less than $0.02 a minute.

In some small island states with a single telephone company, such as Barbados, high charges breed fears of stifling international electronic industries, and lead to a clamour for competition. Not in the Maldives, where the tourism industry does most of the international telephoning. For all the government's public commitment to competition, it seems more likely to give priority to connecting its islands to the mobile network. Besides, when it has a 55% stake in Dhiraagu, why change?

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European competition law

Battling over bricks

Aug 23rd 2001 | PARIS
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A growing row over intellectual-property rights

IN EARLY July, on the same day that he blocked General Electric's merger with Honeywell, Mario Monti, Europe's competition commissioner, also ruled on another interesting case. It involves IMS Health, an otherwise obscure gatherer of health-care information for drug companies. The case is controversial because it involves copyright laws that are already subject to painstakingly negotiated international agreements. Worse, it threatens an ugly row between the European Commission and national governments.

At the heart of the dispute is a method of data collection known as the “brick” system. Bricks are geographical blocks used to break down countries and cities into meaningful units for analysing sales of drugs. IMS Health uses its bricks to track doctors' prescriptions and drug sales at pharmacies. Drug companies pay for the analysis and use it to determine product strategies. In theory, anybody can build their own brick structure by choosing where to set the boundaries, and a particular set of bricks can be copyrighted under standard intellectual-property rules. IMS Health's copyrighted structure for Germany, for instance, consists of 1,860 bricks.

Until 1999 IMS Health had the German market to itself. Since then, though, it has fought a running battle there with two would-be competitors: NDC Health, an American rival, and AzyX Geopharma, a Belgian group. These companies tried to create their own brick structures for Germany, only to find that most drug companies wanted either IMS Health's existing structure or something based directly on it. IMS first refused to license its copyright to competitors and then successfully sued them for infringement when they launched rival products, winning injunctions in Germany's local courts. Excluded from the market, NDC and AzyX lodged a complaint with the commission at the end of last year. Mr Monti ordered an investigation on competition grounds.

In July, the investigation ended with a stunning ruling. For only the second time in its history, the commission imposed “interim measures”, ordering IMS Health immediately to license its copyright to competitors and describing a clear abuse of a dominant market position. However, Mr Monti also said that there were exceptional circumstances to justify the ruling and that the market concerned was “a very peculiar one”. On August 6th, IMS Health appealed against the ruling. Europe's Court of First Instance has suspended the interim measures while the appeal is being heard. The court will probably announce its decision next month.

To what extent can a company assert intellectual property rights when it dominates a market?

The case touches on several sensitive issues. One is a legal question over a company's ability to assert intellectual property rights when it dominates a market. The commission's view is that IMS Health operates what amounts to an industry standard (in competition jargon, this is known as an “essential facility”) in Germany, and that for there to be fair competition it must license its copyright. IMS Health argues that its brick structure is not a standard because drug companies do not have to use it—they choose it because IMS Health had the foresight to create a product that would appeal to them. Lawyers are still arguing over whether the commission has the legal authority to override international agreements on copyright.

Undoubtedly the commission's position breaks new legal ground. Previous spats over essential facilities have occurred when the owner of something in one market, for example a harbour, has blocked entry to competitors in another market, for example a ferry operator. This case is unprecedented because it concerns only one market. Is the commission defending competition—or is it attacking IMS Health merely for having created and protected a genuine competitive advantage?

A further sensitive issue is that IMS Health has consistently won its defensive fight in German courts. On June 19th, a specialist appellate court ruled on an appeal by NDC to lift an earlier injunction won by IMS Health that had stopped it from developing a product based on IMS's brick structure. Not only did the judges uphold IMS Health's copyright, but they also explicitly referred to the commission's investigation by saying that the brick structure could not be seen as an essential facility in Germany. How does Mr Monti square his decision to ignore the court findings in Germany with his broader goal of encouraging local implementation of European competition law? The commission says that, by the time the German court case is over, which could be two or three years off, would-be competitors to IMS Health will long since have been forced to withdraw from the market. Curiously, if that were to happen, Germany's drug companies would be in the same market position that they accepted quite happily in 1999.

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Media-buying agencies

Monkey puzzle

Aug 23rd 2001
From The Economist print edition

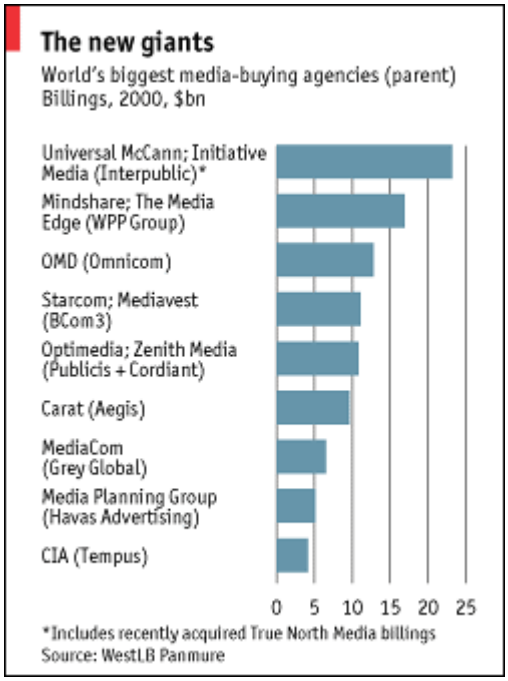
A transformation of the media industry is behind the bidding war for Tempus

"GORILLAS with calculators" is how creative types used to deride media buyers. If the creative side of advertising was considered the sexy bit of the business, then media buying was for number-crunching nerds. But, as the current scramble to snap up Tempus, a British media-buying agency reveals, this back-room industry is now firmly in the limelight.

The tussle for this prize began on August 20th, when Sir Martin Sorrell, head of WPP, the world's biggest advertising group, put in a bid for Tempus, valuing it at £437m ($631m). Tempus's managers, who had already accepted a lower offer last month from Havas Advertising, the fifth-biggest advertising group, say they will now reconsider. Although WPP has offered Chris Ingram, Tempus's boss, the joint top job in the combined media-buying group, he is known to be wary of Sir Martin. And Havas is widely expected to raise its own bid, although it was staying mum this week.

Europe's third-biggest media-buying agency, and one of the few that is still independent, Tempus would fit neatly with either of its suitors. Were Sir Martin to win it, this would reinforce WPP's joint dominance of the industry, along with Interpublic, the American advertising giant (see chart). In CIA, which makes up the bulk of Tempus's business, it would have a strong European media-buying operation to complement the American orientation of WPP's The Media Edge. And, claims WPP, the fusion would provide "synergies" of at least £13m.

For Havas, adding Tempus would swell the French group's share of the media-buying market by 80%, to 9.2%. Havas also reckons it could find cost savings from the merger of *euro*20m ($18m) next year. While WPP would remain strong in media-buying even without Tempus, Havas badly needs the acquisition for its weak media-buying business to rival the global giants.



Why this commotion over a modest British firm? After all, it is small beer for Sir Martin, who only last year paid $4.7 billion for Young & Rubicam, an American advertising giant. The answer is that the media-buying industry has been transformed, because the media industry itself has changed, in two important ways.

The first is the fragmentation of media. Only a decade ago in Europe, when cable and satellite television were fledgling businesses, media buyers did little more than negotiate the price for a spot on a television network. Today, pay-TV is in about half of all West European homes. As the number of channels through which an advertiser can reach an audience has proliferated—multi-channel TV, the Internet, wireless telephony, not to mention older ideas such as magazines or billboards—it has become harder than ever to grab the consumer's attention.

Hence the fresh appreciation for the job done by all those number-crunchers with their spreadsheets and calculators. "Media-planners and buyers used to be treated by creative people as second-class citizens," says Sir Martin. "Now they have equal, in some cases greater-than-equal, status." As its profile has risen, and the specialist media-buying agencies have honed their skills, the business has become lucrative. Margins in media-buying are around 20%, compared with about 15% for creative agencies. The service has become all the more valuable now that advertising budgets are being so sharply cut. "They are the

people who can make your money go further," as one advertiser puts it.

The second change is the consolidation and globalisation of the media groups themselves. For media buyers to have any clout in negotiating rates with these giants they need scale. This explains the consolidation within the media-buying industry too. Only last month, Interpublic merged its media-negotiating businesses into a single worldwide unit, Magna Global. Also in July, Britain's Cordiant Communications and France's Publicis agreed to combine their media-buying divisions.

In this rush, many independents have been hoovered up already. Tempus, founded, part-owned and still run by Mr Ingram, is one of the few left. Another is London-based Aegis, whose media-buying agency has a market share more than twice that of Tempus's CIA. Indeed, there is a suspicion that it is Aegis, not Tempus, that Sir Martin is really after.

Naturally, Sir Martin dismisses the idea as a "red herring": Aegis, as its boss, Doug Flynn, has repeatedly said, is not for sale. But that was what Mr Ingram used to say about Tempus. "Sorrell can't lose," says one industry rival. If he wins Tempus, he will have strengthened his business. If he loses, he will have weakened a competitor, Havas, by forcing it to overpay. He will have pushed up the price he gets for a 22% stake in Tempus that he already owns. And he could still choose to court Aegis, widely regarded as the bigger prize.

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African airlines

A new Air Afrique?

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What to do with a troubled West African airline

EVERYONE who works in Africa has a horror story about flying with Air Afrique. Created in 1961 by newly independent West African governments, it was once a symbol of regional integration. Over the past few years, though, it has been on the verge of collapse, crippled by ballooning debts, appalling service and ludicrous overemployment. It has 4,200 employees and eight aeroplanes. (By comparison, Britain's budget EasyJet, with 21 aeroplanes, employs 1,400 staff.)

Now, the airline may get a fresh start. On August 14th, the heads of state of the 11 African countries that own 68% of the company agreed to an Air France proposal to shut it down. Some of its assets, including the brand name and landing rights, would be transferred to a new company, leaving the present airline's debt behind. The shareholding countries would reduce their aggregate ownership to between 22% and 28%, and Air France's share would increase from 12% to 35%. Private investors would own the remainder.

Last January, with an $800,000 World Bank grant in hand, shareholders called in Simat, Helliesen and Eichner (SH&E), an American air-transport consulting firm. Jeffrey Erickson, who presided over the restructuring of TWA, was appointed to head a transition management team. He found chaos: the company's accounting system had shut down in 1999, so that it produced no accounts; local offices ran their own finances; many passengers travelled free; and almost every flight was either late or cancelled. The timetable was not changed even after exasperated creditors had repossessed three aeroplanes.

His team put financial controls in place, and revised routes and schedules. About 60% of flights are now on time. The number of free or discounted tickets has been cut. As a result, both passenger numbers and income have been rising.

According to Mr Erickson, however, Air Afrique still employs 2,000 too many people and cannot service its debt. Hence the African shareholders' decision to bite the bullet. But the usual political squabbles lie ahead. Abdoulaye Wade, president of Senegal, has said that all of Air Afrique's employees will keep their jobs, and that Air France will inject fresh working capital into the company. Air France maintains that it has made no such financial commitment, and that the new Air Afrique should start with half its present staff. Without speedy agreement on the details, Air Afrique may yet vanish into thin air.

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Face value

Starwood's shooting star

Aug 23rd 2001
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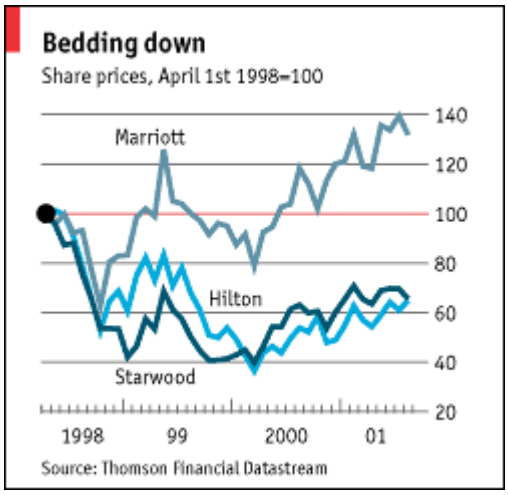
Barry Sternlicht is great at doing deals. But how good is he at running companies?

IF THERE is one person who doesn't have to worry about finding a bed for the night, it is Barry Sternlicht. He can walk into any of 740 hotels in 80 countries, from the St Regis in New York to the Danieli in Venice, and demand a room. This is one of the perks of being chairman and chief executive of Starwood, which Mr Sternlicht turned from a small property company into one of the world's largest hotel groups through a series of daring takeovers that culminated in the $14.6 billion contested acquisition of ITT, owner of Sheraton, in 1998.

Mr Sternlicht may have made buying hotels look easy—though he was helped by Starwood's advantageous tax structure and a share that did credit to its ticker symbol, HOT. But he has found running them more challenging. Starwood's shares have underperformed the American stockmarket by 45% since the ITT purchase. In July it gave a warning that revenues this year might be 2-3% below last year's levels, citing a rapid decline in business travel that is hitting room prices and occupancy rates. As the industry faces its first drop in sales since the 1991 recession, this accomplished deal maker, still only 40, is finding that he has to prove himself all over again—this time as a hotelier.



The nitty-gritty of services does not seem to be Mr Sternlicht's strong suit. It is certainly not what he most likes to discuss. Aggressive, impetuous and thin-skinned, his talk is all about transactions: about how he snatched ITT, then a company with a market capitalisation twice that of Starwood, from arch-enemy Hilton; how that deal came only a month after his purchase of Westin, another hotel chain; and how, during last year's sale of ITT's casino assets, including Caesar's Palace in Las Vegas, he played off rival bidders against each other and ended up netting $3.1 billion, when his number two had been prepared to sell for $2.6 billion. Sheer grit, it seems, has always helped this son of a Holocaust survivor to beat the odds. When he was 14 his doctor X-rayed him and told him he would be short; in defiance, he grew to be five foot ten (1.77 metres).

Such self-belief has not made Mr Sternlicht easy to live with. In the past three years, Starwood has lost six senior executives. Mr Sternlicht fell out with his president, Richard Nanula, an old friend from his Harvard Business School days, whom he had lured from Walt Disney; and with Juergen Bartels, head of the group's hotel operations. The subsequent public criticism of his management style has not mellowed Mr Sternlicht. Quite the opposite, in fact. “I wasn't ready to be as tough as I should have been,” he says. “I didn't know how to let people go. I should have done it all at once. Instead I did it one at a time.”

Mr Sternlicht had certainly clarified who was boss, but the thinning of the top ranks made reorganising Starwood harder, given his limited experience of the hotel business. The most urgent task was to knit together the disparate acquisitions that had brought him a range of overlapping brands, from Sheraton and Westin in the upper reaches of the middle market to St Regis and the Luxury Collection at the top end, and CIGA in Europe. “I inherited three companies, glued them together and hoped it would work,” he remembers. “The whole thing was very dysfunctional."

“I inherited three companies, glued them together and hoped it would work”

Mr Sternlicht has made some quick and obvious changes for the better, including chopping out suppliers—Starwood saved $144,000 a year by reducing (from 17) the number of firms that sell it cookies—and launching a sophisticated loyalty programme for regular guests. He has also introduced six sigma, a system of quality control beloved by GE's Jack Welch. And he has formed an alliance with Cisco Systems to introduce broadband Internet access into his hotels.

These changes have produced some promising results. Starwood's profits and cashflow have grown faster than those of its rivals, Marriott and Hilton, over the past two years. And disposals have reduced the group's $8 billion debt load.

The tougher challenge, however, is to develop a consistent brand image for Starwood, as the economic climate grows bleaker. Mr Sternlicht has models: he cites Target, an American discount retailer, and Starbucks, admiring the coffee chain's ability to “create a lifestyle around a commodity product with declining sales—and make people spend $3 on a cup of hot water.”

He also has a prototype: the 14-strong chain of W hotels, which he dreamed up three years ago, and which seems to be the only topic, other than deals, that excites him. With their emphasis on modern design and pampering service, W hotels are winning plaudits as smart alternatives to conventional luxury lodges.

Fraught franchises

Sadly, Mr Sternlicht also has one big problem. The W chain is under his control, but that cannot be said of the rest of Starwood. The group owns only a fifth of its hotels; most of the rest are franchised. Mr Sternlicht sees this as a serious hurdle. “Unlike Target and Starbucks, we don't control our own distribution,” he observes. “When the head of our design team went to one Westin franchisee to ask him to use a white bedspread to match our brand image, he said ‘but it will stain'. That is the difficulty. We end up arguing over bedspreads.”

Friction with franchisees is likely to increase as the economy slows and occupancy rates fall. There will also be less money to lavish on the W hotels, as Starwood starts to cut capital spending. Mr Sternlicht sounds a bit like somebody trapped in operational management after the deal music has stopped: “It's no fun when your customers go away.” But with Starwood's shares still languishing, it will be hard to pull off another big deal to hold his interest. Then again, the test of a true hotelier is managing through bad times as well as good.

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China's economic challenge to East Asia

A panda breaks the formation

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As a new industrial giant stirs, East Asia's economies fear they must adapt

"I'VE been asking everyone in East and South-East Asia: 'What is your competitive response to China?' I have yet to hear a satisfactory answer," says Victor Fung, a de facto ambassador of Hong Kong's business elite. Most of China's neighbours react to the mainland's industrial rise with a mix of alarm and despair. Japan, South Korea and Taiwan fear a "hollowing out" of their industries, as factories move to low-cost China. South-East Asia worries about "dislocation" in trade and investment flows. Kenichi Ohmae, a veteran Japanese consultant, predicts that China's rise will cause a "second Asian crisis", more severe and drawn-out than that of 1997-98.

It all boils down to this: what will the rest of East Asia do for a living now that virtually everything can be made more cheaply in China? If the fear is correct, adjustment may be painful. For China's rise threatens an end to East Asia's traditional model for economic development.

This model is sometimes called the "flying geese" pattern. East Asian countries started by manufacturing for export simple goods such as shoes or footballs. They then reinvested the profits so as to upgrade their capital stock, exporting more sophisticated goods such as semiconductors and laptops. In the process, wages and living standards rose towards rich-country levels. Japan flew in the pattern first, followed by Hong Kong, Singapore, South Korea and Taiwan. Malaysia, Thailand, the Philippines and Indonesia have followed later.

China is no goose. It does not conform to the (somewhat misleading) stereotype, because it makes simple goods and sophisticated ones at the same time, rag nappies and microchips. If there is a parallel to China's kind of economic development, says Andy Xie, economist for Asia at Morgan Stanley in Hong Kong, then it is America in the 19th century. A surplus of labour keeps wages down, yet consumption grows because prices fall. China makes goods spanning the entire value chain, on a scale that determines world prices. Hence East Asia's anxiety. If China is more efficient at everything, what is there left for neighbours to do?

These fears are greatly overblown, and any government policies shaped to address them would be a mistake. David Ricardo, an early 19th-century English economist, demonstrated that what matters in trade is not absolute cost advantage (which China undoubtedly has in many goods) but comparative advantage. Tim Condon, an economist at ING Barings, illustrates this by adapting Ricardo's original example to modern Asia. China and Thailand both grow rice and make steel. China does both more cheaply, but its cost advantage in steel is greater than in rice. As long as they can trade, both China and Thailand will thus be better off if China makes steel and Thailand grows rice.

One problem may be that this presumes a flexibility that most Asian economies lack. In this example, if all else remained the same (which it won't), closing Thailand's steel industry would mean falling wages in cities and a transfer of wealth to the countryside—a wrench in the short term that may not be politically feasible. But then another point the goose-obsessed miss is that exchange rates move: if China really dominated the export trade its currency would have to rise, and others would fall, evening things out.

The supposed challenge varies for each goose, depending roughly on where in the formation it flies. Japan, for instance, like China, faces deflationary pressures. Unlike China, though, it starts out with a

high cost base. The current migration of low-cost manufacturing from Japan to China therefore makes sense. Japan should benefit from China's rise, as it did from the rise of other East Asian rivals, as it shifts (like America) from manufacturing to higher-value services. In truth, there is no reason why China's growth should not benefit Japan rather than harm it.

The issue for the trailing geese—that is, Thailand, Malaysia, Indonesia and the Philippines—is also relatively clear-cut. In textiles, where country quotas are to be phased out under world trading rules, they stand no chance against China, according to Fred Hu, an economist at Goldman Sachs in Hong Kong. Besides such obvious industries as tourism, he says they should therefore specialise in commodities and agriculture. Thailand, for instance, is unbeatable in shrimp farming, Indonesia in timber, and so on.

And what of the richer East Asians, in Singapore, South Korea and Taiwan? As geese, they flew in the middle, but they could soon be trapped between a new low-cost manufacturing power (China) and a rich-world services centre (Japan). In the early 1990s, during their heyday, these three economies (plus Hong Kong) had a combined GDP one-and-a-half times as big as China's. Today, their combined GDP is about the same as China's. By 2010, Morgan Stanley guesses, it will be half the size of China's, and by 2020 one-tenth. In relative weight, says Mr Xie, these countries are the “vanishing middle”.

The best response by these places could be to allow China to make things that they design. South Korea and Taiwan, for instance, are world leaders in semiconductors. It should be possible to use this position to gain leadership in intellectual, rather than physical, property. Again, the main obstacle is politics. In South Korea, manufacturing is in the hands of industrial conglomerates that are run by families and hamstrung by trade unions that resist any change.

The economy suffering most acutely is Taiwan. Spared recession during the Asian crisis, it is now buffeted by a collapse in world demand for its exports. (For the first time since 1949, Taiwan's economy looks likely to contract this year.) Already, about half of “Taiwanese” computers, digital cameras and motherboards are made on the mainland; in scanners, the figure is almost 90%. Taiwan also suffers a brain drain to the mainland, as many of its brightest sparks seek chances in Shanghai or Guangdong province.

The choice for Taiwan, says Mr Xie, with a degree of theatricality, lies between becoming a Finland or a Hainan. Finland found a successful niche among European rivals by, in particular, designing mobile phones; it has thrived. Hainan is just another southern Chinese island, known especially for its prostitutes. If Taiwan is flexible—as Hong Kong has been, with much success, in adapting to China's rise—then transformation is possible. Only shoddy, inflexible companies in the region, plus their political backers, have reason to be alarmed by rising mainland prosperity.

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Japanese banks and interest-rate swaps

Storing up trouble

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Japan's banks have alarming quantities of derivatives squirrelled away

SOMETHING curious is happening at Japan's big banks. Thanks to an accounting loophole, they are piling up large exposures to derivatives without having to disclose them to investors. Japanese banks are already weighed down by bad loans and loss-making share portfolios. Now, thanks to their enthusiasm for interest-rate swaps, they are even riskier than they already look. Fancy that.

Estimates suggest that the banks have ¥40 trillion ($330 billion) of interest-rate swaps on their books. Since they already own the same amount of government bonds, they have, in effect, quietly doubled their exposure to interest-rate fluctuations. Most of these swaps are placed off the balance sheet, so it is hard to tell exactly how much the banks own, or what proportion of it is longer-dated stuff. Still, people in the market reckon that the average maturity of banks' combined bond and swap portfolios is probably about four years. That means a rise in long-term interest rates of, say, one percentage point could wipe around ¥3.2 trillion off the banks' capital—the equivalent of a year's worth of operating profits.

The best evidence of what the banks are doing lies in the spread between government-bond yields and swap rates. Normally, bond yields are lower, because investors believe that there is less risk that a government, as opposed to a private institution, will default on its debt. Yet because banks, the biggest participants, have generated so much demand for swaps, spreads in the five- to ten-year zone have flattened to virtually zero over the past six months. In some places, swap rates are actually lower than government-bond yields, a trend that alarms many of the banks' counterparties, which are mostly foreign investment banks and hedge funds.

Interest-rate swaps appeal because they help to boost profits, at least for now. In return for a fixed rate of, say, 0.5%, banks use money “borrowed” from depositors to pay a floating rate of interest of 0.1%, pocketing the difference of 0.4 percentage points. This provides handy income at a time when their profits are being eroded by write-offs of bad loans. It also helps ward off the threat of nationalisation. The government owns great wads of banks' preferred shares that could be converted into voting shares should the banks ever fail to earn enough to pay dividends. Still, banks need to keep an eye on short-term rates: should they rise, these earnings would dry up or even turn to losses.

They are able to hide their swap holdings thanks to a loophole in “macro-hedge accounting” rules that has been closed in most other rich-world jurisdictions. Until next April at least, Japanese banks are not required to value derivatives used for hedging purposes at market prices, nor to match them to assets and liabilities of similar maturity. With only a loose cap on how much they may hedge, banks have exploited this to the full.

Thus they have “hedged” their liabilities, mostly short-term deposits, with long-term interest-rate swaps, creating a maturity mismatch likely to widen in future. The government's deposit-insurance scheme runs out next spring, and consumers are already shifting long-term deposits into demand deposits.

The scheme relies on doubtful reasoning by the banks and shoddy inspection by auditors. Macro-hedge accounting rules specifically state that banks may use the loophole only for the purpose of reducing risk—which they claim to be doing. But, critics argue, creating such a maturity mismatch can hardly be classified as risk-reducing; auditors should be stricter. Accountants weakly reply that they must accept the banks' own definitions of risk.

Japan's bank regulators do not seem unduly concerned that the banks are hiding risky derivatives positions. Shareholders, on the other hand, may not be so forgiving. Should large losses on these hidden swaps ever come to light, they may well sue both the banks and their auditors.

For now, however, the chances are high that the banks will be able to keep their swap positions under wraps. The Japanese Institute of Certified Public Accountants, which is due to unveil proposals for new macro-hedging rules next month, is said to be under pressure to extend the loophole by as much as a year beyond next April, to allow banks to get their systems ready to meet the new regulations.

In the meantime, there is always the risk that long-term interest rates could go up sooner, and more sharply, than banks expect. Last week, the Bank of Japan loosened monetary policy for the second time this year, and hinted at more easing to come. This, quite plausibly, might weaken the yen, which, in turn, might cause nominal long-term interest rates to rise, and bond prices to fall. When this starts to happen, banks could be forced to renegotiate with their swap counterparties, or to put up more cash.

This would be disastrous for them, since they have little, if any, free capital to fall back on. The Japanese stockmarket is close to a 17-year low, and the economy is still spluttering. Banks are under pressure to rid their loan books of bad debts, and are fast running short of reserves. What they are doing with interest-rate swaps could make another dent, both in their capital and in their credibility.

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Recriminations against Wall Street

Bubble and squeak

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Attempts to hold Wall Street to account for the dotcom bubble, contd

THE public outcry after the 1929 crash made cleaning up Wall Street a hot political issue. Within five years, an unregulated market had been made subject to a raft of new laws, and had gained a regulator, the Securities and Exchange Commission (SEC). The tech-share crash of last year has also excited politicians in Washington, who blame Wall Street hype for inflating the bubble.

Investment banks, whose behaviour is also under scrutiny by regulators as well as the courts, are nervous about where all this might lead. Many have made changes, mostly modest, to their procedures. CSFB, the bank under greatest pressure, recently replaced its chief executive and has now appointed a former SEC official—Gary Lynch, the man who hunted down Ivan Boesky and Michael Milken—as its general counsel.

Leading the political attack is Richard Baker, a congressman from Louisiana who chairs the House sub-committee on capital markets. His first target is conflicts of interest at investment banks—institutions that help companies to sell their shares, all the while supposedly helping investors to sort out good shares from bad. Next, Mr Baker plans to take a hard look at how investment banks allocated shares to investors in initial public offerings (IPOs), an area also subject to legal investigations.

Wall Streeters fear that Mr Baker is that dangerous animal, a politician with an eye for the main chance. Tampering with the securities houses' mix of banking and research, the head of research at one Wall Street giant claims, “could destroy the capital-raising machinery of this country and drive the IPO market offshore.”

Yet Mr Baker appears pragmatic enough. Merrill Lynch and CSFB have barred research analysts from buying shares in companies they follow. Mr Baker does not think banks should be forced to go that far—provided there is full disclosure of whatever analysts do. He also recognises that Wall Street firms have different kinds of business model, and that across-the-board rules may be unhelpful. Instead, investment banks may be required to choose what sort of firm to be: say, one that bans its analysts from investing or one that does not.

Mr Baker says he wants to avoid new legislation, so long as the industry “responds appropriately”. Rather, he prefers to work with the SEC, whose new chairman, Harvey Pitt, he reports to be both “expert and helpful”.

As yet, nobody is making the sort of radical proposals that would wholly remove the conflicts of interest—for instance, by requiring research and investment banking to take place in separate firms. Wall Street houses argue that this would be hugely inefficient, and that, anyway, their analysts were bullish not in order to keep the bankers happy, but because they believed, albeit wrongly, in the dotcoms they were touting.

Possibly. At any rate, analysts generally made clear to investors that these shares were risky. There have been out-of-court settlements, notably Merrill Lynch's recent one with a client unhappy at a buy recommendation made by Henry Blodget, the firm's dotcom analyst. A judge's swift and entertaining dismissal this week of lawsuits over bullish research recommendations by Morgan Stanley's “Internet queen”, Mary Meeker, is more likely to be the norm. The judge, who described the allegations as “in grossly bad taste”, is evidently no politician.

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Equity underwriting in Europe

Unusual suspects

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From The Economist print edition

Local commercial banks in Europe did a rotten job of underwriting IPOs

CALL it relationship banking. In early 1999, Lothar Mark, head of Gontard & MetallBank, a small German bank, is said to have urged an entrepreneur to sell his remaining stake in the company he had founded. Sound advice, as it turned out. The company in question, Refugium, an operator of old people's homes, carried out a secondary public offering, led by Mr Mark's bank, but later lost 99% of its market value. It has since filed for insolvency amid allegations of accounting fraud and breach of trust by its directors.

Public prosecutors are still investigating the affair, but they suspect that Mr Mark may have had foreknowledge of the troubles ahead. After all, he was deputy chairman of Refugium's supervisory board. His bank had introduced the company to the Neuer Markt, Germany's market for growth stocks.

Refugium's close relationship with its underwriting bank is hardly exceptional. During the European equity gold rush of the late 1990s, it was mainly local commercial banks that cashed in, dominating especially the business of underwriting growth stocks in Paris and Frankfurt. Companies often felt they had a moral obligation to use their traditional bank when going public, says Götz Gollan from Equinet, a firm which advises companies on going public. After all, that bank had often provided financing when times were bad.

In many cases, neither side was quite ready. For many smaller banks, underwriting the initial public offerings (IPOs) of growth stocks was their first brush with investment banking. In 1995, there were less than a dozen active equity underwriters in Germany. By 1999, there were 52; today there are over 100. Most of the buyers during the boom were retail investors, and placing the shares was easy. In the late 1990s, almost every issue seemed to fly.

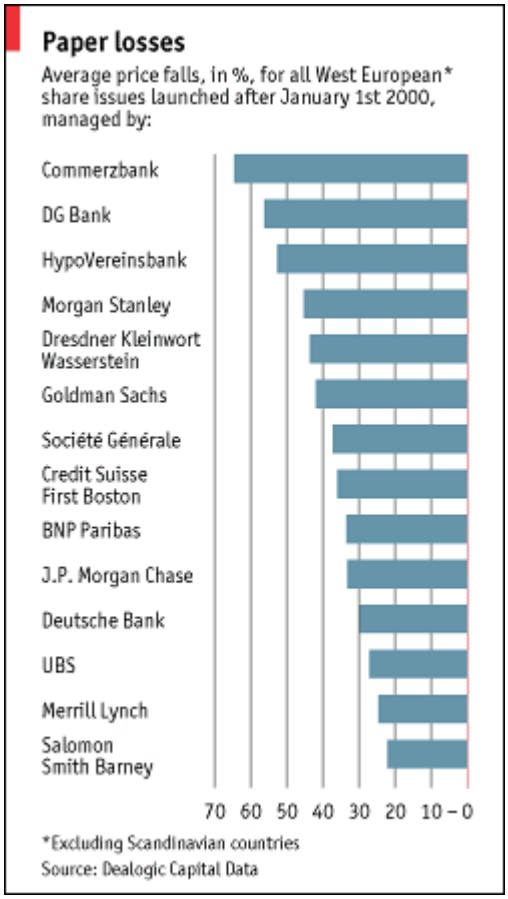
No longer. Following 18 months of scandals involving many of the former stars on Europe's growth markets, the Refugium affair is unusual only in that it involved not a technology company but what plausibly passed as a share for widows and orphans. Some 30 companies are either insolvent or have fallen so much that they are likely to be expelled, like Refugium, from the Neuer Markt. With five flops, Gontard & MetallBank, which traces its origins to the early 18th century, is an unfortunate market leader.

Commerzbank, DG Bank (now called DZ Bank, after a recent merger) and HypoVereinsbank head the list of larger underwriters whose offerings have underperformed, according to Dealogic Capital Data, an investment-banking research firm. Investors who subscribed to all their IPOs since January 2000 would have lost more than half their money (see chart).

They could blame the banks' inexperience as underwriters. But some fund managers claim that “Chinese walls”, the barriers that are meant to separate investment advice from corporate finance, were not just semi-permeable, as on Wall Street, but non-existent. In some cases, research analysts worked alongside auditors to produce an offering prospectus. Their reports were often even more positive than the prospectus itself and were used to market the issue. That would be impossible in America or Britain, where “blackout” periods apply before an IPO.

Moreover, after an IPO, commercial banks in continental Europe continue to provide loan finance, and sometimes keep an equity

stake. Especially in Germany, senior bankers often sit on the supervisory boards of companies covered by their research department. Conflicts of interest appear even bigger and more entrenched than on Wall Street. Some, in particular Dresdner Bank and Deutsche Bank, have tried to establish better underwriting practices. Their IPOs have done comparatively well. Many other German banks are only now discovering the word compliance.



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Fiscal policy in the euro area

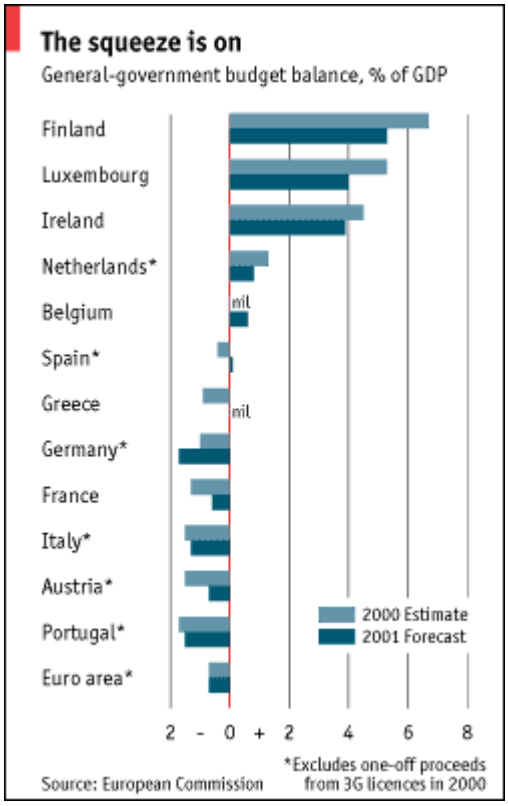
Eichel rocks (and rolls)

Aug 23rd 2001 | FRANKFURT
From The Economist print edition

A remark by Germany's finance minister has renewed chatter about the euro-area's stability and growth pact

A WARNING to music lovers: steer clear of the German finance ministry's website. (Oh, if you must: the address is www.bundesfinanzministerium.de.) You hear there "Wer sonst?"—"Who else?"—a song in praise of Hans Eichel, the finance minister. Sample, made no worse by translation: "He, he, he is thrifty and hard-working and sometimes generous. He, he, he—who else?"

Mr Eichel does indeed have a reputation for being tight with the nation's money. In the past few days, though, the finance minister may have wished that he was equally thrifty with his words.



A sharp slowdown in the German economy—which, said official statisticians on August 23rd, did not grow at all in the second quarter—has made it likely that Mr Eichel will miss his budget-deficit target for the year. This is not only a domestic issue. The euro area's "stability and growth pact" is supposed to keep national governments on the fiscal straight and narrow now that monetary policy is run by the European Central Bank. Might it not be better, Mr Eichel mused, to set targets for government spending, which he thinks can be planned more precisely than budget deficits (that is, spending less revenue)?

A wish to rewrite the stability pact, from the country that had insisted on setting it up? *Handelsblatt*, a German business daily, reported that Mr Eichel and Laurent Fabius, his French counterpart, were cooking up a plan. No, no, chorused the Germans, the French and Pedro Solbes, the European commissioner responsible for monitoring compliance with the pact. The pact is super as it is.

The trouble is that governments are being pulled in two directions. On the one hand, the pact is a commitment to fiscal prudence. Governments have to publish annual targets. Budget deficits of more than 3% of GDP are punishable by fines (though no deficits are yet close). Lesser transgressions incur censure from the European Commission. In Mr Solbes's view, four of the euro zone's 12 countries have fundamental work still to do: Germany, France and Italy (the three biggest), plus Portugal. Italy has promised to balance its budget by 2003; the rest by 2004.

On the other hand, economic slowdown has pushed down revenues and increased spending, compounding the effects of tax cuts already on the way. When Mr Eichel set his budget target last November, he expected German GDP to grow by 2%, giving him room to cut taxes and still keep the budget deficit to 1.5% of GDP. Now economists say the economy will grow by 1% this year, and Stefan Bergheim of J.P. Morgan in Frankfurt expects a budget deficit of more than 2%.

Normally, falling taxes and rising spending act as "automatic stabilisers" that help set the economy right. That is fine, by Mr Solbes's lights, in countries where fiscal policy is already in order. But in the four erring countries, he says, the stabilisers should not be used to the full. Portugal recently produced a supplementary budget to tighten things a little.

To make matters trickier, national elections are due next year in France and Germany. That is adding to domestic pressure to ease the squeeze: Mr Eichel has already agreed to increase child benefit and is gamely resisting calls to bring forward tax cuts planned for 2003.

All this ensures that any hint of budget backsliding will make headlines. Yet despite his hurried clarification, Mr Eichel has a point. The focus on a single year's target does not do justice to his budgetary austerity—or, as the song has it, to his efforts at saving with an “iron hand”. All together, now.

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Economics focus

1492 and all that

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Did Europe's "age of discovery" give birth to an age of globalisation?

THE word "globalisation" is a new one, coined in the age of Davos and the Big Mac. But global economic integration is an old process—and just how old is the stuff of fierce debate. There is plenty of evidence that, in several ways, international economic links were closer in the 19th century than in much of the 20th. Some go farther back, to the trade boom that followed the voyages of Christopher Columbus and Vasco da Gama at the end of the 15th century. But why focus on Europe, say others? Dennis Flynn and Arturo Giraldez, of California's University of the Pacific, reckon that the world economy was "born" in the 1570s, by which time trade linked Europe, the Americas, Asia and Africa.

Yet a provocative recent paper* argues that there is little evidence that world markets were truly integrated before about 1800. Kevin O'Rourke, of Trinity College, Dublin, and Jeffrey Williamson, from Harvard University, agree that European trade with the rest of the world boomed after 1500. It rose by about 1.1% a year over the next three centuries, probably faster than GDP. Evidence, surely, of global integration?

Not enough for economists, say the authors. For the test is not the quantity of trade, but the price of traded goods. In a single market, the price of spices relative to, say, the price of grain ought to be the same everywhere. If the relative price of spices was much higher in the Netherlands than in the East Indies, that would create profitable opportunities for pepper exports to the Netherlands. As supply increased, however, the price gap should have closed. So if the world economy was becoming more integrated in the 16th, 17th and 18th centuries, relative prices in Europe and its new trading partners in Asia and the Americas should have moved closer together.

The trouble, say Mr O'Rourke and Mr Williamson, is that nothing of the sort seems to have happened. For example, the mark-up on cloves imported into Amsterdam from South-East Asia fell in the first half of the 17th century, and then soared: it was far higher throughout the 18th century than it had been in the 17th. Contrast this with the 19th century—a period previously studied by the pair—when relative prices did converge.

Which raises two questions. Why did prices not converge? And, if market integration did not cause the trade boom, then what did? The answer to the first question is straightforward: trade was not free. There were high import tariffs, and trade was dominated by state-sponsored monopolies, such as the Dutch and British East India Companies. So there was little chance of the gap between prices in Asia or the Americas and Europe being narrowed by competition.

The answer to the second question lies in a combination of rising import demand from Europe, and rising export supply from Asia and the Americas. In some periods, demand was the main cause; in others, supply. The authors argue that European import demand depended on the incomes of the richest classes, the only people likely to be able to afford such luxuries as spices, coffee and foreign cloth. Because these people were landowners, their fortunes hung on the price of land, which in turn may have been linked to population growth. When the population increased, this drove up the demand for land and therefore rents, putting more money in landlords' purses. It explains most of the increase in trade in the 17th century—when rising demand also pushed up the relative price of imports—and more than half of the increase in the 18th century.

However, during the 16th century European landlords' incomes fell. The chances are that import demand was also weak. The relative price of Asian imports al so fell during the century, while that of goods from the Americas rose. So the increase in trade during that period was probably based on an increase in the

supply of goods from Asia to Europe.

Autarky and the Manila galleon

Controversially, Mr O'Rourke and Mr Williamson wonder whether Chinese trade policy may have been a cause of this. From the middle of the 15th century, China stopped sending naval and “treasure” fleets abroad; thereafter its trade policy varied, but was officially far less open, even autarkic. If China, then a huge power accounting for perhaps one-quarter of world GDP, stepped back from trade, could it be that exports from the rest of Asia were diverted towards Europe? Europe's trade boom would then be a product not of global economic integration, but of its opposite.

Students of China are sceptical. Maybe, says Kenneth Pomeranz of the University of California, Irvine, the policy of autarky did have some effect. But the Chinese remained the biggest traders at important South-East Asian ports. “For most of the period,” he says, “there really was no Chinese withdrawal from trade.”

In a new paper†, Mr Flynn and Mr Giraldez chart the enormous flows of Latin American silver to China between 1500 and 1800, for use as currency. In the early 16th century, the price of silver in terms of gold was about twice as high in China as in Europe; the price gap lasted from 1540 until it disappeared under the weight of increased silver production, mainly from Latin American mines such as the great complex at Potosi, by about 1640. The huge, enduring arbitrage opportunity drew in the metal: Spanish galleons brought more than 50 tons a year from Acapulco to Manila, whence Chinese merchants carried it on. Another big price gap opened up in the 18th century. Meanwhile, Chinese silk, porcelain and tea flowed out of the country. “The idea that China was autarkic in this period is a ridiculous myth,” says Mr Flynn.

Still, say Mr O'Rourke and Mr Williamson, the effect of China's policy, especially on relative commodity prices, is worth quantifying. The idea that China was trading all the while does not mean that the official policy had no effect. And if the effect was small, then why did Asian export supply expand? China aside, there is a lot else for historians to argue about. Evidence, anybody?

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* “After Columbus: Explaining the Global Trade Boom, 1500-1800”, by Kevin O'Rourke and Jeffrey Williamson. Centre for Economic Policy Research, 2001.

† “Cycles of Silver: Global Economic Unity through the mid-18th Century”, by Dennis Flynn and Arturo Giraldez. Forthcoming, the *Journal of World History*.

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Correction

Aug 23rd 2001
From The Economist print edition

In our issue of August 4th, we accompanied an article on Nomura Securities with a chart of the share price of Nomura, an unrelated company making exhibition displays. Our apologies.

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Private nature reserves

Freelance conservationists

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From The Economist print edition

Private parks are springing up all around the world. If conservationists are to achieve their goals, therefore, they must work with the private sector

IN THE days of Captain Cook, Hawaii's native goose, the nene (pronounced neh-neh), was abundant. By the 1950s it was almost extinct. What nearly cooked this particular goose was not, however, the Hawaiian habit of baking it in underground ovens for supper, but the loss of its habitat—most of which has become farmland. Today, successful captive breeding programmes have produced hundreds of nene, but that is only half the battle. If the goose is to prosper, it must be returned to the wild. That means restoring its habitat. And that, in turn, means dealing with the private landowners on the island of Molokai whose property is the most suitable for nenes to live on.

According to researchers at a meeting of the Society for Conservation Biology held in Hilo, on Hawaii, earlier this month, the nene is not alone. Many conservationists see government-run national parks as the key to the survival of endangered species. In America, however, between a third and a half of such species are believed to live only on privately owned land. And in many other countries the role of private reserves is even more crucial. The national parks in impoverished tropical countries are often poorly protected or even poached with the connivance of corrupt officials—and some exist only on paper. In these places, private parks may actually offer better protection to wildlife than their publicly owned counterparts. Governments that care (or wish to be seen to care) about wildlife conservation would thus do well to encourage the growth of private reserves.

Money isn't everything

As Jeffrey Langholz, a researcher in international environmental policy at the Monterey Institute of International Studies, in California, told the conference, private reserves already constitute about an eighth of the total amount of land on which wildlife is protected around the world. And in some countries, notably Brazil, Chile, Colombia, Kenya and South Africa, their area is growing fast.

Unfortunately, while many governments would like to encourage private conservation, they often have little idea how to do it. That, in turn, is due to a misunderstanding about why people have set up such reserves in the first place. For example, Dr Langholz has surveyed the owners of many private reserves in Costa Rica, where they protect some 640km^2 of land. He found that government offerings to these owners—in the form of tax breaks, protection against occupation by squatters and access to technical assistance—had little incentive value.

While many governments would like to encourage private conservation, they have little idea of how to do it

That was because the majority of owners are not motivated primarily by money. Only 30% of them rely on their reserves for a steady stream of income, in the form of revenue from “ecotourists”. (This may be abnormally low: a wide-ranging survey of private reserves in Africa and Latin America suggests that 59% of those that host ecotourism are profitable.) Most owners say they are more concerned about threats to biodiversity, and what they see as the failure of governments to promote conservation. One, who prefers to remain anonymous, used to run one of the

largest logging operations in the Amazon. Now he is dedicated to protecting his private reserve of 10km^2 of Costa Rican forest in penance for his earlier career.

Even profitable reserves frequently have their revenue devoted to conservation, rather than the owner's bank balance. Some idea of the economics involved can be gathered from the example of a Costa Rican reserve that made profits of more than $3m in its first six years of operation. The owners used $1.2m of that to pay off the loan for the original land purchase. But instead of spending the rest on champagne and cruises, they invested another $1.1m in an endowment fund that is intended to pay for the reserve's protection in perpetuity.

Costa Rica is not alone in this potential misunderstanding between governments and landowners, though the details differ from place to place. In the United States, for example, landowners' perceptions are often that the government is doing too much for conservation, not too little.

A few years ago a scheme for registering natural landmarks, including the habitats of endangered species, in America, backfired because it failed to take account of the country's strong tradition of property rights. Even today, after the scheme has been made voluntary (it was originally compulsory) it is still regarded by some landowners as part of a conspiracy by the government to acquire control of their property.

A similar problem was encountered with the Endangered Species Act. Initially, this had the perverse effect of making it harder to persuade people to agree to promote habitat conservation on their land. The fear was that the arrival of a rare species would restrict the use an owner could make of that land in the future. An experimental scheme is now trying to get round this, granting exemptions from such restrictions for those who “invite” rare species on to their property.

Many private owners favour conservation over profit

Not all American landowners feel the same way. In Hawaii, regarded by some as the “world capital” of extinction because of the number of unique species it has lost since it was first settled by people, the largest private landowner in the state is prepared to compromise profit for conservation. Kamehameha Schools is a trust that owns 1,500km^2 of land (originally a legacy from one of Hawaii's last princesses). The trust's income is used to run schools for Hawaiian children. Most of this income, though, comes from investments rather than land exploitation. As a result, half of the trust's land is kept for conservation purposes and generates no revenue at all.

This apparent contradiction of the trust's official purpose is justified, according to Peter Simmons, its senior land manager, because, as Hawaiian landowners, the trustees “care spiritually, and in some cases religiously, about the land”. This, he says, is connected to the belief that livelihood and quality of life are directly related to the quality and life of the land.

Noble sentiments. And ones that seem to motivate many custodians of private reserves in other countries, too. Whether they will be enough to re-establish the nene, remains to be seen.

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Brittlestar eyes

Unity in diversity

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From The Economist print edition

What constitutes an "eye" is not as obvious as it might seem at first sight

IN GREEK mythology, Argus had 100 eyes, while the Cyclops had but one. Reality, though, is sometimes stranger than myth. If Joanna Aizenberg, of Lucent Technologies' Bell Laboratories, in New Jersey, and her colleagues are correct, there is a real creature that combines these legends perfectly—and to add to its monstrous qualities, has five arms and no head. It is *Ophiocoma wendtii*, a brittlestar. According to their paper in this week's *Nature*, this animal has a single eye, but that eye is made not of 100, but of thousands of components, and is scattered over the whole of the animal's upper surface.

Gordon Hendler, a biologist who was one of Dr Aizenberg's collaborators, was intrigued by differences between the behaviour of *O. wendtii* and some of its relatives. *O. wendtii* is sensitive to light. It can detect shadows and escape from predators into dark crevices, which it is able to "see" from a distance of several centimetres. It also changes colour between day and night. During the day it is brown. At night it is striped in black and grey. Its "blind" relatives show none of these features.

Brittlestars, which are related to starfish and sea urchins, have external skeletons. These skeletons are made of crystals of calcite—the mineral of which chalk is composed. On *O. wendtii*, however, some crystals have a shape that looked to Dr Aizenberg and her colleagues distinctly like lenses. To find out if they really act as lenses, the researchers cleaned and polished a piece of skeleton, and laid it on a piece of "photoresist", a light-sensitive material used during the manufacture of computer chips. They then shone a light through the skeleton to see what would appear on the photoresist.

The result was a pattern of spots that shows that the lens-like crystals do indeed behave as lenses. What is more, by analysing this pattern the team demonstrated that in a living animal the lenses would focus light on to bundles of nerves found in the skeleton. That would explain a general sensitivity to light. But Dr Aizenberg goes further, suggesting that the whole system of lenses and nerves may act as a single "compound" eye, similar in principle to that of an insect.

Compound eyes consist of lots of small lenses, whose individual images are "post processed" into a single big one by the nervous system. For that to work, each lens must respond to light coming from only one direction. Applying optical theory to *O. wendtii* lenses suggests that they would, indeed, behave in that way.

On the other hand, for a compound eye to be effective, its elements must point in lots of directions, in order to cover a wide visual field. Adjacent lenses in *O. wendtii* are generally attached to the same individual plate of the external skeleton, so they all point in more or less the same direction. Such adjacent lenses could not, therefore, form an eye. But if all the lenses on all the plates were linked in a collaborative network (which, given the layout of a brittlestar's nervous system, is possible), information from many directions could be added together to give an image of everything above the animal. In other words, the lenses would collectively form a single eye. That matches the facts quite nicely.

Lucent's interest in sea creatures is not entirely academic, despite Bell Labs' honourable history of pushing back the frontiers of human understanding. Micro-optics is an important field of technology, and is crucial to the company's telecommunications-related product lines. Perhaps brittlestars will shed some commercially useful light on it.

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Parkinson's disease

Movement difficulties

Aug 23rd 2001
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People with Parkinson's disease often suffered from constipation earlier in life

FEELING a little stopped up? Can't get relief? Research in Hawaii suggests that constipation, especially when it defies laxatives, could be an early symptom of Parkinson's disease. The more constipated you are, the more likely you are to go on to develop the neurological problems that cause the muscular tremors which characterise Parkinson's.

The research, published recently in *Neurology* by Robert Abbott of the Pacific Health Research Institute in Honolulu and his colleagues, examined data on 6,790 Japanese-American men. These men were participants in a long-term health study as one part of which, from 1971 to 1974, they reported the frequency of their bowel movements. Over the subsequent 24 years, 96 of them went on to develop Parkinson's disease.

That patients with Parkinson's often suffer constipation is well known—James Parkinson himself noted it when he characterised the syndrome in 1817. But Dr Abbott wanted to know if the men who eventually got the disease were blocked in the bathroom long before other symptoms started to show up.

Intriguingly, they were. The fewer their daily bowel movements during the early 1970s, the greater their risk of developing the disease. Those who reported less than one movement a day were 2.7 times more likely to develop Parkinson's than those who had one a day—and 4.5 times more likely to do so than men who boasted more than two each day. Also significant is the finding that men who used laxatives but got little relief from them were the most likely of all to develop Parkinson's.

All this suggests to Dr Abbott that Parkinson's may not be simply a disease of the brain, as is now believed. It may, rather, be something more systemic. The pathology of constipation and the pathology of Parkinson's disease are similar, he says. In particular, Parkinson's is associated with a lack in the brain of a messenger molecule called dopamine. Nerve cells in the colons of constipated people lack dopamine, too. Even more intriguingly, nerve cells in the colons of Parkinson's sufferers who are constipated contain structural abnormalities known as Lewy bodies, which are a hallmark of the affected brain tissue in people with Parkinson's. In other words, the first sign of the movement disorder associated with Parkinson's may be in the gut, not the brain.

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Studying hurricanes

Storm troopers

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A step forward in the understanding of hurricanes should soon take place

The big picture

CRAZY as it sounds, the “Hurricane Hunters” squadron of America's Air Force Reserve has been flying into storms since 1944. No matter how intrepid its pilots, though, the squadron's aircraft can penetrate only the middle slices of the storms of interest. Below an altitude of 1.5km, conditions are too harsh to fly safely. Above 10km, the modified cargo planes that the Hurricane Hunters use are physically incapable of venturing. So, despite the excitement of the ride, the squadron has been able to provide only partial information to researchers trying to build models of how hurricanes behave.

This year's forays will be different. The squadron will be collaborating with the Fourth Convection and Moisture Experiment (CAMEX-4), organised by NASA, America's National Aeronautics and Space Administration, in a rare integration of that agency's responsibilities for flight within and beyond the atmosphere. The result should be a clearer total picture of any hurricanes that threaten the Atlantic coast of America this season.

CAMEX-4 opened for business on August 20th, when the object of its attention was a tropical storm, Chantal. Unfortunately—at least from the experimenters' point of view—Chantal failed to develop into a full-fledged hurricane. Nevertheless, she gave the team the chance to try out the instruments and techniques which, it is hoped, will yield an accurate picture of what goes on inside a hurricane.

One of CAMEX-4's innovations is the use of unmanned aircraft. These propeller-driven reconnaissance drones are made by Aerosonde, an Australian company, and are known by the same name. They will, for the first time, allow researchers to study the lowest layers of a hurricane—between 200 and 500 metres above the ocean surface. Aerosondes should be able to fly for up to 30 hours in these conditions, gathering data on temperature, pressure and humidity, as well as measuring the speed and direction of the wind. Most should survive the experience. But if conditions prove too extreme, and one is lost, no pilot goes down with it.

Using unmanned aircaft, researchers will be able to study the lowest layers of a hurricane for the first time

The experiment will also use three relatively new satellites. *QuikSCAT*, which went up in June 1999, carries an instrument called a radar scatterometer. This works by scattering microwave radiation from the ocean surface to measure the speed and direction of the wind. *Terra*, launched in December 1999, studies light reflected from clouds in order to work out their heights and directions of motion. Unlike earlier satellites of this type, which have orbital periods of 24 hours and thus hover over one spot on the earth's surface, *Terra* orbits every 100 minutes. Hovering satellites must collaborate to make their measurements (by triangulation). *Terra* can take measurements of the same cloud from different angles, but in quick enough succession to do its own triangulation.

The third satellite, *TRMM*, the Tropical Rainfall Measuring Mission, was launched in November 1997 and is also the first of its kind. It uses the microwaves emitted naturally by raindrops (their so-called black-body radiation, a function of their temperature) to assess the quantity of water falling from a storm's clouds. Since most hurricane-related deaths are caused by inland flooding, the CAMEX team is particularly interested in investigating the link between hurricanes and rainfall.

The aerosondes and satellites will be working alongside a civilian version of a U-2 spy plane (used to

collect data from an altitude of 20km) and a modified DC-8, which does the donkey work at 10km. These aircraft carry “dropsondes” that fall through a storm, gathering data from intermediate altitudes as they go. The Hurricane Hunters, meanwhile, will fly at their traditional altitude of 1.5-3.5km.

Hurricanes, when they land, cause billions of dollars of damage. Forecasting helps reduce that. However, existing models may err by as much as 250km in predicting landfalls. Integrating the data from aircraft, dropsondes and satellites should allow better models to be built. That, in turn, will allow predictions to be more accurate, and even, according to Steve Hipskind, CAMEX's project manager, to be made from satellite data alone. When this happens, the Hurricane Hunters may finally be able to hang up their hats.

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War and its victims

The first casualty

Aug 23rd 2001
From The Economist print edition

EPA

Despite 50 years of international agreements to protect them and wider use of humanitarian intervention, civilians are still war's primary victims

IT IS a simple, if lamentable, fact that civilians die in war. There is no such thing as a pure military conflict. Civil wars, which account for many of today's conflicts, involve particularly high levels of civilian deaths. But wars between nations in the past century took their own monstrous toll of non-combatants—tens of millions in the second world war alone.

In the years following the shock of the first world war this slaughter was explained, though hardly justified, by the concept of total war. Adopting a crude Darwinism, soldiers and politicians argued that wars were now about national survival: whole societies fought wars, and whole societies could become targets of blockade, or bombing, or racist atrocity. The bitter war between Germany and the Soviet Union was the apotheosis of this new vision. Atrocity against civilians became routine and, in this case, civilians fought back, with no holds barred.

The horrors of the second world war forced the developed world to confront these issues. In 1949, a redrafted Geneva Convention extended protection to civilians in war; the United Nations took up the cause of human rights; other laws and conventions make clear that civilians have an unquestionable right to be safeguarded in conflicts of any kind. Simon Chesterman's collection of conference papers, sponsored by the International Peace Academy, shows how little this right has been respected or enforced. Since 1945, 90% of war's casualties have been civilians (though the distinction between armed civilian and regular soldier is now blurred in many contexts).

Only in the last decade has any serious effort been made to intervene in civil wars where one side or the other has clear genocidal ambitions. Even in Bosnia and Rwanda thousands died before the international community could decide who should intervene and when. Is there an answer? Two papers explore the possibility for better protection, but neither says anything very surprising beyond insisting on greater understanding of local conditions and the need for speedier and more focused intervention. Yet the arguments surrounding the efforts to establish the International Criminal Court, agreed in Rome in 1998, show that politics still rule. Intervention is a function of the

Civilians in War
Edited by Simon Chesterman

Lynne Rienner Publishers; 292 pages; $19.95. Eurospan; £16.95

Buy it at
Amazon.com
Amazon.co.uk

Hell in the Pacific
By Jonathan Lewis and Ben Steele

Channel 4 Books; 286 pages; £16.99

Buy it at
Amazon.co.uk

The Bridge at No Gun Ri: A Hidden Nightmare from the Korean War
By Charles J. Hanley, Sang-Hun Choe and Martha Mendoza

Henry Holt; 314 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

distribution of international power and the self-interest of the prominent power-holders. Kuwait apparently had to be defended; but which interventionist lobby would insist on installing UN troops in Chechnya, or secure an international peacekeeping force in Northern Ireland or Israel?

There is in this situation an enduring puzzle. Since 1945 the United States has been essential to almost all big interventions, particularly where large-scale force is required—Korea, Vietnam, the Gulf, the Balkans. Yet the United States is commonly distrusted by other states, as its humanitarian impulses often appear to mask commercial pressure or strategic necessity. Above all, America's own record has been held up to increasing scrutiny. Saving civilians has often involved military atrocity and civilian deaths.

Two other books explore this ambiguity. “Hell in the Pacific” is a spin-off from a grim series made for British television. Few people need to be reminded of how hideous the Pacific war was, but the book is unremitting in cataloguing the savagery of all sides in the conflict. Let there be no doubt that those allied soldiers who shot Japanese prisoners, or threw them alive from aeroplanes, or laughed as Japanese soldiers writhed in the flame-thrower's embrace did so in reaction to the bestiality of the enemy and the widespread climate of racism that reinforced harsh reprisals. Japanese soldiers, it is clear from this account, brought a great deal of inherited cultural baggage with them when they treated their prisoners atrociously, though this explains rather than excuses. Nonetheless, the United States air forces in their turn burned hundreds of thousands of Japanese civilians to death in the firebombings of 1945, and in a minute extinguished the lives of tens of thousands in Hiroshima and Nagasaki.

In “The Bridge at No Gun Ri” three journalists have dug up an atrocity from the Korean war in which American soldiers were ordered to bomb and shoot hundreds of defenceless Korean refugees approaching American lines. The reconstruction is faithfully and meticulously undertaken, but is certainly not bed-time reading, any more than “Hell in the Pacific”, whose stomach-turning narrative should carry a warning for the faint of heart. This particular Korean tragedy was avoidable, but the deaths of thousands of other Koreans, caught in the cold-war crossfire, were not. Even in Kosovo, where NATO aircraft forced an end to the “ethnic cleansing”, Serb civilians were victims of the bombing. Intervention is never frictionless. Civilians, however neutral, are always in the way, and deserve better. As one survivor of the massacre of women and children at No Gun Ri remarked years later: “Some say war is war and it's dirty. But still what's wrong is wrong.”

Intervention remains necessary where a clear humanitarian disaster cannot be prevented by local forces. Examination of America's own chequered record should not make us abandon that principle. On balance, more harm than good is likely to come from western intervention. But when it happens every effort should be made to respect local interests, international law and humanitarian agreements. This is not about winning markets or the moral high ground. It is about saving genuinely innocent lives on all sides.

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“Apocalypse Now Redux”

Aug 23rd 2001
From The Economist print edition

Francis Ford Coppola's 1979 Vietnam-war film, “Apocalypse Now”, has been re-released with a latinism added to the title and 49 minutes to its length. This unwieldy but powerful epic about the horror of war finally looks set to survive its critics.

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New fiction

Signifying nothing

Aug 23rd 2001
From The Economist print edition

HAVING moved to New York from London last year, Salman Rushdie has been quick to turn his American experiences into a novel. “Fury” is set unmistakably in Manhattan during the summer of 2000. “Gladiator” is playing in cinemas and around America trundle “the motorcades of two largely interchangeable and certainly unlovable presidential candidates”.

Fury
By Salman Rushdie

Random House; 272 pages; $24.95. Jonathan Cape; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Malik Solanka, a Bombay-born, Cambridge-educated millionaire, has come to New York to escape a disintegrating marriage and the bouts of uncontrollable fury that have started to afflict him. In a country where, as Mr Rushdie puts it, “the transformation of the self is a national industry”, he hopes to reinvent himself as a more peaceable man. Written in a hybrid of sophisticated journalese and conventional realism, the first two-thirds of “Fury” follow Solanka's misadventures in America, and by flash-back tell the story of his former life.

In the concluding part of the novel, however, Mr Rushdie shifts without warning into the magical realist mode with which he is often associated. Solanka falls in love with Neela, a woman so improbably beautiful that she causes passers-by to crash their vehicles and fall down flights of steps. When Neela travels to the mythical Lilliput-Blefuscu, an archipelago of islands in the Indian Ocean where a coup has occurred, Solanka follows her and finds himself caught up in dangerous events that are bizarrely of his own making.

“Fury” pursues a theme which will be familiar to readers of “The Satanic Verses” and “Shame”—the increasing confusion between image and reality in the late-capitalist world. Unfortunately, in “Fury” this theme seems to have confused Mr Rushdie himself: the plot lines barely link up with each other and the dogleg into magical realism is perplexing and ineffective.

If “Fury” is Mr Rushdie's bid to write a Great American Novel, he has been brought low in the attempt. Although “Fury” starts well, combining acuity of description with thumping readability, it soon loses its way. Mr Rushdie is usually too effervescent a writer to be pompous, but here he is drawn into making overwrought and grandiose pronouncements on the state of America. His narrative voice slides frequently into portentousness. “Fury—sexual, Oedipal, political, magical, brutal—drives us to our finest heights and coarsest depths. Out of *furia* comes creation, inspiration, originality, passion, but also violence, pain, pure unafraid destruction.” So Mr Rushdie tells us, but he does not prove his flurry of words. Less furious than spurious, this will not be counted one of his best books.

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About sponsorship

Contemporary Turkey

In need of air

Aug 23rd 2001
From The Economist print edition

Crescent and Star: Turkey Between Two Worlds
By Stephen Kinzer

Farrar, Straus and Giroux; 252 pages; $25

Buy it at
Amazon.com
Amazon.co.uk

FOR Western Europe, Turkey is an often irritating neighbour; one who has too many smelly barbecues, who prays too noisily and too early, and who teaches its children too much submissive obedience. As with many irritations, this one is mingled with a dash of fear. “The Turks”, said Martin Luther in the 1520s, “are the people of the wrath of God”, and traces of the slur still stick.

The trouble with neighbours is that they are there. Not that the West particularly wishes to lose this one, which provides a buffer against more troublesome nations beyond, in the rather arbitrary division of the world's greatest landmass that Europeans have decreed should be called Asia. The more neighbourly option—learning to live together—begins with understanding, and this critical but affectionate portrait of Turkey's recent history throws considerable light on the complex ways of this strategically important ally of the West.

Stephen Kinzer is good at illuminating the dark underbelly of the Turkish state, starting with the Armenian massacres of 1915 and moving on to the Kurdish civil war of the past decade, the endemic brutality of the police force, and the anti-Islamic prejudices of its military and Kemalist establishment. The average Turk knows even less about his country's past treatment of the Armenians, for example, than the average Englishman knows about his country's past deeds in Ireland. Mr Kinzer correctly argues that Turkey needs to confront its own history, warts and all, if it is to stand up to what can sometimes come across as the self-righteousness of its allies and neighbours.

Mr Kinzer was the *New York Times*'s correspondent in Turkey for four years, between 1996 and 2000, and like many people thrown into fascinating and fast-changing situations for short periods of time, he has succumbed to the temptation to believe that what happened during his watch marked a turning point. He makes much of the friendship fostered between Greeks and Turks by the earthquakes around Izmit and Athens in 1999, when suspicious neighbours on opposite sides of the Aegean sent rescue teams to each other's disasters. The only unusual thing about these acts of kindness is that it suited the purposes of George Papandreou and Ismail Cem, the enlightened foreign ministers of Greece and Turkey at the time, to make much of them. Their predecessors were sabre-rattling megalomaniacs; their successors may well be too. Meanwhile, on an individual level, Greeks and Turks will continue to be perplexingly close.

Mr Kinzer also makes much of the capture in the same year of Abdullah Ocalan, the notorious leader of the PKK, the Kurdish guerrilla movement, a man for whom he has few kind words, despite his general sympathy for the Kurdish cause. Of the video of Mr Ocalan's dramatic arrest in Nairobi, he writes, “a man who could order executions between dinner courses without the slightest disturbance to his digestion, blubbered like a child.”

At his trial Mr Ocalan produced the most extraordinary *volte face* of recent times. “I want to dedicate my life to bringing Kurds and Turks together,” he announced. And Mr Kinzer sees this as the turning point in the long and bloody struggle between the two groups. But the struggle was merely one symptom of a far deeper malady in modern Turkey that it will take more than Mr Ocalan's conversion to cure. This malady is the inability to accommodate dissent. So tightly did Kemal Ataturk (described by Mr Kinzer as “the greatest proto-European in Turkish history”) seal his new republic that it has been in danger of suffocation almost ever since. The Turkish republic today needs to realise that it is a rare breath of fresh air that carries a deadly virus.

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Russian history and culture

Defining a nation

Aug 23rd 2001
From The Economist print edition

Kormya Dvuglavogo Orla (Feeding the Two-Headed Eagle).
By Andrei Zorin.
Novoe Literaturnoe Obozrenie; 415 pages; 120 roubles

THE sudden crash of Soviet ideology, the search for a national idea under Boris Yeltsin and the restoration by Vladimir Putin of abandoned symbols of Russian nationhood—all of it in ten crowded years—are rich soil for historical reflection. In this fascinating book, Andrei Zorin, a prominent historian of Russian culture, goes back to the writings of the late 18th and early 19th century to find sources of the patriotic ideals and cultural myths which animated—and continue to animate—the ideology of the Russian state.

The detail and subtlety of Mr Zorin's new book may be glimpsed from one or two of the topics it touches. Russia's Greekness is one theme. Mr Zorin opens with the Greek project of Catherine the Great (1729-96), an attempt to define a cultural role for Russia in Europe as heir to Athenian civilisation by way of the Byzantine state—the vector for Christianity in medieval Russia. The later empire never absorbed Greece itself, but it swept up the Crimea, a Byzantine outpost scattered with antiquities, and the attendant myth of Crimea as Russia's very own Arcadia survived into the Soviet period. The cession of Crimea to Ukraine in 1991 is lamented in Russia more than the loss of any other territory.

Another of Mr Zorin's themes is the enemy within, illuminated by the story of Mikhail Speransky. Under Catherine, Western Europe ceased to be a model to Russia, as it had been for Peter the Great, and became instead a source of evil, brimming with unchristian freemasons and hostile plots. The son of a village priest, Speransky was a statesman and reformer, who fell foul of aristocratic enemies. In 1812, the year of Napoleon's invasion, he was denounced as a French spy, a traitor corrupted by Jews, and sent into exile.

Mr Zorin is too much of a historian to draw explicit parallels between the past and now. Yet it is hard not to read him without them springing to mind. Speransky's sorry tale was repeated many times—and with far crueller means—in the Soviet period. It has obvious echoes now: Anatoly Chubais, for example, Yeltsin's right-hand man, was demonised by some of his compatriots for selling out to western capitalism. “Feeding the Two-Headed Eagle” deserves to be translated into English. Though scholarly, it speaks to today, written as it is by someone who has experienced doctrinal change at first hand.

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About sponsorship

Where dogs come from

Barking up the evolutionary tree

Aug 23rd 2001
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NEXT time you see a stray dog nosing around in a pile of rubbish, save your pity. According to Raymond and Lorna Coppinger, the grubby mongrel is doing what evolution designed it for.

Dogs: A Startling New Understanding of Canine Origin, Behaviour and Evolution
By Raymond and Lorna Coppinger

Scribner; 352 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

The main theme of “Dogs” is that the species was not, as widely thought, domesticated by man, but domesticated itself. Dogs have evolved, according to the Coppingers, from a wolf-like ancestor by adapting to a new ecological niche: rubbish dumps of human villages, which provided food that did not have to be chased after. The shared characteristics of village dogs the world over—small brains and teeth compared with wolves of the same size, an adult weight of 10-15kg, two litters a year instead of a wolf's one—are fine-tuned to this environment by natural selection. And so-called mongrels are the very best form of an animal that is, in many ways, more distinct from wolves than wolves are from their wild relatives, coyotes and jackals.

This contrasts with the conventional view that dogs are descended from wolves that were tamed and used as hunting companions by people. Indeed, the Coppingers, who have studied dogs for three decades, believe that working dogs, such as hunting hounds, sheepdogs (particularly those that guard sheep rather than herding them) and even sled dogs have evolved from ancestral village dogs by a process that owes more to Darwin than to selective breeding of the sort that has created modern, registered breeds.

Cruft's aspirants will be depressed to learn that the Coppingers frown on selective breeding. Closed stud-books result in the exposure of harmful recessive genes. And that is before the selection of exaggerated—and to the animal, damaging—traits that are thought of as breed-specific. The authors are also critical of dog-training programmes—including those for guide-dogs for the blind and deaf—that ignore the right learning-stages in young pups.

This all may sound over-doctrinal. But “Dogs” avoids a nature-nurture conflict. The postulation of genetically determined key periods for learning suggests how genetic and environmental factors may work together to create patterns of behaviour. “Dogs” will be interesting to anyone who has ever wondered about the origin of their favourite mutt's species.

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Theatre history

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Live theatre looks flat and static on the small screen. But all who love the stage will want to see “Changing Stages”, a six-part television documentary on 20th-century English-speaking theatre by Sir Richard Eyre, ex-director of Britain's National Theatre. Shown last year in Britain, it airs (two parts an evening) on America's public-television network on August 26th and the two following Sundays. Covering America, Britain and Ireland, it starts with modern treatments of Shakespeare, and ends with Broadway and today's avant-garde. “Changing Stages”, a book co-written with Nicholas Wright, accompanies the series (Knopf; $40. Bloomsbury; £30).

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Contemporary theatre

Light and shadows

Aug 23rd 2001
From The Economist print edition

All the world's a stage in Julie Taymor's global theatre

Julie Taymor pulls in all ages

TWO remarkable current productions in London, “The King Stag” and “The Lion King”, raise fascinating questions about the globalisation of theatre and the cross-connections between mass entertainment and the mainstream stage. The two plays are necessary viewing for anyone interested in the future of theatre.

The link between them is Julie Taymor, the brilliant Massachusetts-born director and stage designer who makes such extraordinary use of masks, puppetry and movement, much of it inspired by a postgraduate sojourn in Asia. A student of the great Paris mime, Jacques Le Coq, she made an award-winning career in America before her stellar success three years ago with a production on a cleaned-up Broadway of “The Lion King”, adapted from the original Disney cartoon film.

In London, Ms Taymor has again directed “The Lion King”, and designed and choreographed “The King Stag”, a fairy tale about a king seeking a wife, by Carlo Gozzi (1720-1806), a Venetian playwright hostile to realism who incorporated elements of *commedia dell'arte*. For all their differences, Ms Taymor's ingenuity is evident in both pieces. The one is a global mega-hit engineered by a world media giant with the capacity to mount simultaneous productions in America, Asia and Europe. The other is a revival of the American Repertory Theatre's 1984 production, again directed by Andrei Serban. Taken together, the two illustrate Ms Taymor's flexibility in satisfying Disney values while continuing to mount adventurous theatre.

The minimalist staging of “The King Stag” allows you to focus on the luminous beauty of Ms Taymor's fragile marionettes. As in “The Lion King”, seeing the puppeteers at work is a delight for children and adults, generating spontaneous oohs and aahs. Yet the Gozzi play avoids a weakness in “The Lion King”, which is so packed with things to see that spectacle threatens to drown expressive detail.

Theatrical arts are deployed differently in the two productions. In “The King Stag” the artifice of distorted face masks and comic hand gestures lends depth to the contrasting femininities of Clarice and Angela, played by Kristine Goto and Sarah Howe. Brechtian banners illustrate each scene, all the while punctuated by percussion and a discrete musical score. Other elements, including Bunraku puppetry and suitably garish costumes, are incorporated in the overall theatrical artificiality with grace and wit.

“The Lion King” has an equally impressive range of theatrical elements. But they tend to merge into a latter-day version of a Wagnerian total art work. Shadow puppets, for example, which are used with evanescent charm in “The King Stag”, are never quite allowed to take centre stage in “The Lion King”. And if Wagner's music has a relentless grandeur, Elton John's score for “The Lion King” is relentlessly anodyne, and relieved only rarely by allusions to African vocal music.

A minor technical hitch in the “Lion King” performance seen by this reviewer generated a kind of sympathetic warmth among the audience otherwise precluded by the impressive production machine. There is, too, a shallowness in the homogenisation of African cultures and something ultimately wearing in the allegorical use of animals. On stage, Ms Taymor has brought depth and shade to Disney's over-lit and sanitised cartoon-world. But her justly admired spectacle cannot entirely disguise a hollow centre. By contrast, the old-man puppet in “The King Stag” reveals human warmth, frailty and honesty at the centre of theatrical artifice.

This production of Gozzi's play owes much to the public-service culture of university drama departments. The American Repertory Theatre is a non-profit company based in Cambridge, Massachusetts, and associated with Harvard University. Yet, as if to illustrate the complexity of the linkages between arts and morals, it has also received backing from AT&T and from a project called CrossCurrents that is sponsored by Philip Morris, a tobacco giant.

In many ways, “The King Stag” is the more historically alert and theatrically sophisticated production. Yet it has undeniable aesthetic similarities to “The Lion King”. One thing both productions do superlatively well is to offer simultaneous fun for kids and beguiling pleasures for grown-ups.

“The King Stag”, Barbican Centre, London EC2, August 15th-September 2nd 2001; “The Lion King”, Lyceum Theatre, London WC2.

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Bestsellers in Spanish

What the world is reading

Aug 23rd 2001
From The Economist print edition

Spanish-language books in Spain and America

LATINOS comprise 12.5% of the population of the United States and are its fastest-growing ethnic group. Yet *Criticas* magazine reports that few bookshops are seeing a corresponding increase in sales of Spanish-language titles. Our United States lists come from Lectorum in New York, the largest bookshop of its kind in the country. Its fiction list reflects the tremendous popularity of Latin American greats such as Mario Vargas Llosa, Isabel Allende and Paulo Coelho. Remarkably, there is only one novel in translation, Arthur Golden's “Memorias de una geisha”. The non-fiction list, by contrast, is dominated by media gossip and computing manuals.

Spanish readers, meanwhile, seem preoccupied with history and politics—from Antonio Muñoz Molina's novel of those dispossessed by Nazism and Stalinism and a fictionalised life of a Belle Epoque courtesan to biographies of Joan the Mad and Spanish political activists.

Plato provides an unexpected link between Spain and America. Two novels, Jose Carlos Somoza's “La caverna de las ideas” and Jose Saramago's “La caverna”, take Plato's academy as a setting or a thematic starting point, while Lou Marinoff invokes the great thinker in his arrestingly titled self-help book, “Mas Platon y menos Prozac”.

Bestsellers

	SPANISH FICTION (UNITED STATES)	SPANISH NON-FICTION (UNITED STATES)
1	**La fiesta del chivo** *by Mario Vargas Llosa* Dark meditation on the nature of dictatorship	**A la caza del leon** *by Jorge Ramos* Reflections of a TV journalist
2	**El alquimista** *by Paulo Coelho* Shepherd's journey of self-discovery	**Obtenga su porcion** *by Julie Stav* Financial planning tips
3	**El vendedor de sueños** *by Ernesto Quiñonez* Tough times in Spanish Harlem	**Lo que vi** *by Jorge Ramos* Further journalistic adventures
4	**Memorias de una geisha** *by Arthur Golden* Fictionalised life of a good time girl	**Detras de la mascara** *by Jorge Ramos* More behind-the-scenes gossip
5	**Retrato en sepia** *by Isabel Allende* Family drama	**Internet para todos** *by Jaime Restrepo* Introduction to the Internet
6	**En el tiempo de las mariposas** *by Julia Alvarez* Dramatised life of Mirabel sisters	**Revelaciones** *by Karina Yapor* Racy revelations of a pop groupie
7	**Hija de la fortuna** *by Isabel Allende* Historical romance	**De DOS a Windows** *by Jaime Restrepo* Getting to grips with computers
8	**La casa de los espiritus** *by Isabel Allende* Classic of Chilean magic realism	**Windows 95/98 para todos** *by Jaime Restrepo* Computer mysteries revealed
9	**Paula** *by Isabel Allende* Memoir of author's daughter	**Juventud en extasis** *by Carlos Cuauhtemoc Sanchez* Enjoying your love life
10	**La caverna de las ideas** *by Jose Carlos Somoza* Philosophy and murder in Plato's academy	**Contraveneno** *by Carlos Cuauhtemoc Sanchez* Surviving divorce

	SPANISH FICTION (SPAIN)	SPANISH NON-FICTION (SPAIN)
1	**La aventura del tocador de señoras** *by Eduardo Mendoza* Catalan detective yarn	**Fish!** *by Stephen Lundin, Harry Paul and John Christensen* Management parable
2	**De todo lo visible y lo invisible** *by Lucia Etxebarria* Tale of all-consuming passion	**Mis inmortales del cine** *by Terenci Moix* Film critic's Hollywood top 40
3	**Pachucha tirando a mal** *by Alfonso Ussia* Young nobleman casts off maternal yoke	**Juana la loca** *by Manuel Fernandez Alvarez* Life of a schizophrenic Spanish queen
4	**La hija del curandero** *by Amy Tan* Chinese-American family drama	**Mas Platon y menos Prozac** *by Lou Marinoff* Take philosophy, not anti-depressants
5	**Sefarad** *by Antonio Muñoz Molina* Lives broken by Nazism and Stalinism	**Dios, el diablo y la aventura** *by Javier Reverte* Adventures of a Jesuit explorer
6	**La montaña del alma** *by Gao Xingjian* Exile and self-discovery	**Maquis: Historia de la guerrilla antifranquista** *by Secundino Serrano* Life of a political guerrilla
7	**El jardinero fiel** *by John le Carré* Diplomat takes on pharmaceutical giant	**Perdonen las molestias** *by Fernando Savater* History of Basque nationalism
8	**La piel del cielo** *by Elena Poniatowska* CLove and astronomy	**Era medianoche en Bhopal** *by Dominique Lapierre and Javier Moro* Chemical disaster in India
9	**La caverna** *by Jose Saramago* Plato, pottery and modern life	**Arzallus: La dictadura del miedo** *by Isabel Duran and Jose Diaz Herrera* Biography of a Basque leader
10	**La bella otero** *by Carmen Posadas* Life of a Belle Epoque courtesan	**El club de la comedia presenta...** *published by Aguilar* Sketches from TV comedy show

Sources: Lectorum; *El Cultural* — Descriptions by *The Economist*

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About sponsorship

Donald Woods

Aug 23rd 2001
From The Economist print edition

Donald Woods, who cried for freedom, died on August 19th, aged 67

Reuters

HE WAS a white South African who became famous by speaking for a black South African, Steve Biko, who believed that a white should never speak for South Africa's blacks. The relationship between Donald Woods and Steve Biko provided one of the many paradoxes that apartheid threw up.

Mr Biko was a leader of a movement called “black consciousness”. He argued that South Africa's blacks could free themselves only by their own efforts, primarily by believing in their own power. They should, he said, shun white liberals who claimed to speak for them because they, too, diminished the ability of black people to stand on their own feet.

Donald Woods was editor for 12 years of the *Daily Dispatch*, a newspaper based in East London, in Eastern Cape province. He met Mr Biko first in 1973. Both men were well-read, articulate and had a sense of humour. Crucially, they were, despite their deep political differences, without fear of each other. Mr Woods was to write in his biography “Biko” that “in a journalistic career in which I met and interviewed some of the great figures in British, Canadian, American and German politics, this man Biko might conceivably be the most impressive of them all.”

Mr Woods was already challenging the Vorster government in the courts. He was involved in 37 lawsuits with the regime in his years as editor and won every case. He was once sentenced to six months in jail but won on appeal. He was awarded damages for libel from several ministers and remarked that the proceeds had paid for a swimming pool and a piano.

Steve Biko was tortured to death by South African police in 1977. Mr Woods demanded a public inquest. Eventually he got one and the lies of the police and indifference of the politicians were exposed. But the regime sought to silence him. He was confined to his house and told he could meet no more than one person at a time, including members of his family. His words could not be quoted or published.

The tool of law

Donald Woods had grown up close to black people. His father was a trader who dealt with blacks, and Donald spoke the local language, Xhosa, fluently. Still, as a young man, he recalled later, he had no problem with seeing “blacks as inferior” and “easily accepted the general white attitude that colour and race were the determinants of the chasms in culture.” He studied law at Cape Town university, a training that was to help him in his court battles with the government. He stood for parliament for the liberal Federal Party. When he lost he turned to journalism, joining the *Daily Dispatch*, later gaining experience in Europe, then returning to the *Dispatch* where he was eventually made editor. The banning order made it impossible to run his newspaper properly. His family came under threat. One of his children was hurt when she tried to put on a T-shirt that had been sent to his home doused in acid. He decided to get out. Disguised as a priest, he escaped to Britain where he was joined by his wife Wendy and their five children.

He had a wonderful tale to tell and the newspapers were full of it. Richard Attenborough made a film about him called “Cry Freedom”. Mr Woods flew around the world lecturing and writing. He became the first private citizen to address the United Nations Security Council and he briefed the then United States president, Jimmy Carter, on what he should do about South Africa.

The impact was immense, partly because Mr Woods was an affable, ordinary sort of man who was happy to talk about cricket and chess as much as racism. Despite the impact that Mr Biko had made on his life he still sounded like a white liberal. Indeed, Oliver Tambo, then president of the African National Congress (ANC), urged him not to join the movement but to remain a detached commentator. Mr Woods could explain to the outside world what it was like to be on the receiving end of apartheid. He and the film “Cry Freedom” helped to change the western view of apartheid. Mr Woods said it was evil and he was believed. As well as “Biko” he wrote “Asking For Trouble”, an autobiography, and most recently “Rainbow Nation Revisited”, about South Africa's first ten years of democracy.

During Mr Woods's years in exile, some of Steve Biko's colleagues had been furious that he appeared to be cashing in on the relationship. They resented the way he had been lionised outside South Africa, while many blacks who had suffered far more had been ignored. Black South Africans did not find it easy to get political asylum in Britain or visas to visit other countries. Mr Woods was sympathetic to such feelings and did not react bitterly. He helped to set up a trust to help black South Africans get university places in the United States and Britain.

He returned to South Africa in 1990, did much to help improve standards of journalism there, and spoke out for liberal values. He attacked attempts by the ANC government to muzzle the press, though not as fiercely as he had attacked the apartheid regime. He kept his main home in Britain where just recently he had been campaigning to have a statue of Nelson Mandela erected in Trafalgar Square.

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Overview

Aug 23rd 2001
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America's Federal Reserve cut interest rates again. The federal-funds rate, the overnight rate at which banks lend to each other, was lowered by a quarter-point to 3.5%, bringing the Fed's total interest-rate reductions this year to three percentage points. However, this failed to impress stockmarkets: the Dow Jones Industrial Average lost 0.7% over the week, and the Nasdaq lost 3.1%.

The latest economic data sent mixed signals. America's index of leading indicators improved for the fourth consecutive month, and preliminary results from the Michigan survey of consumer confidence showed the index rising in August from 92.4 to 93.5. But a survey by the Philadelphia Fed suggested that business activity was deteriorating sharply. The consumer-price index (CPI) fell by 0.3% in July, led by a 5.6% drop in energy prices. The core index, which excludes food and energy prices, rose by 0.2%. Both the overall and the core CPI were 2.7% higher than a year previously.

Germany's GDP stagnated in the second quarter, leaving output only 0.6% higher than a year ago. But things may be looking up. Germany's IFO index of business conditions beat all expectations. The index rose to 89.8 in July, from June's five-year low of 89.5. The business-expectations component of the index rose sharply, while the current-conditions component fell.

Industrial production in the 12-nation **euro area** grew by 0.6% in June, leaving it 1.4% higher than a year ago. The unexpected rise was led by strong growth in durable-goods production, which increased by 0.9% over the previous month.

According to revised GDP figures, **Japan's** economy expanded by 0.5% in the first quarter instead of contracting by 0.8% as had been previously supposed. But evidence that the economy shrank sharply in the second quarter is mounting. The all-industries activity index plummeted by 1.9% in the second quarter, its first quarterly fall since 1998. The drop was led by sharp falls in industrial output and construction.

The **dollar** continued to lose ground against the euro. It is now trading at about 9% below its value at the beginning of July. However, the quarterly exchange-rate forecast from J.P. Morgan Chase (see table) sees the dollar strengthening again over the next 12 months. The Japanese yen is expected to weaken over the next three months before recovering.

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Output, demand and jobs

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% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	1 year	1 year	latest	year ago
Australia	+ 4.3	+ 2.1 Q1	+ 2.6	+ 4.0	– 1.4 Q1*	+ 0.7 Q2	6.9 Jul	6.1
Austria	+ 1.6	+ 2.2 Q1	+ 1.8	+ 2.3	– 3.6 May	– 1.5 Apr	3.8 Jul	3.6
Belgium	+ 1.8	+ 2.4 Q1	+ 2.1	+ 2.4	– 0.5 Jun*	– 3.4 May	11.1 Jul*	11.2
Britain	+ 1.0	+ 2.1 Q2	+ 2.2	+ 2.7	– 2.2 Jun	+ 6.0 Jul	5.0 Jun‡	5.5
Canada	+ 2.5	+ 2.6 Q1†	+ 2.2	+ 3.1	– 0.7 May	+ 3.6 May	7.0 Jul	6.8
Denmark	– 4.6	+ 1.0 Q1	+ 1.4	+ 2.1	+ 4.4 Jun	+ 3.0 Jun	5.2 Jun	5.4
France	+ 2.0	+ 2.7 Q1	+ 2.2	+ 2.4	+ 2.3 Jun	– 2.5 May	8.8 Jun	9.5
Germany	nil	+ 0.6 Q2	+ 1.2	+ 2.0	+ 1.1 Jun	+ 0.5 Jun	9.3 Jul	9.5
Italy	– 0.5	+ 2.0 Q2	+ 2.0	+ 2.3	– 3.1 Jun	– 1.2 May	9.5 Apr	10.7
Japan	+ 0.5	+ 0.2 Q1	– 0.5	+ 0.7	– 8.7 Jun	– 1.0 May	4.9 Jun	4.7
Netherlands	+ 1.6	+ 1.5 Q2	+ 2.0	+ 2.8	+ 0.7 Jun	+ 1.5 Mar	2.0 Jul§	2.6
Spain	+ 4.1	+ 3.3 Q1	+ 2.7	+ 2.9	– 2.6 Jun	na	12.8 Jun	14.2
Sweden	+ 1.3	+ 1.4 Q2	+ 2.2	+ 2.7	– 1.0 May	+ 2.1 Jun	4.2 Jul*	5.2
Switzerland	+ 7.4	+ 2.5 Q1	+ 1.7	+ 2.0	+ 5.1 Q1*	+ 8.4 Jun	1.7 Jul*	1.8
United States	+ 0.7	+ 1.3 Q2	+ 1.6	+ 2.7	– 3.2 Jul	+ 2.5 Apr	4.5 Jul	4.0
Euro area	+ 2.0	+ 2.5 Q1	+ 1.9	+ 2.3	+ 1.4 Jun	+ 0.5 May	8.3 Jun	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 0.4	+ 3.4 Q1	na	na	– 3.2 Jun	+ 4.2 Apr	7.6 Jul*	7.8
Greece	na	+ 2.52000	na	na	– 0.8 Mar*	+ 5.1 Mar	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.5 Apr	1.5
Ireland	na	+12.1 Q4	na	na	+13.9 Jun*	+ 0.7 May	3.6 Jul	4.0
Luxembourg	na	+ 8.52000	na	na	+ 1.4 May*†	+ 9.1 Jun	2.4 Jun	2.7
New Zealand	+ 0.9	+ 0.4 Q1	na	na	+ 0.9 Q1*	+ 7.2 Q2	5.2 Q2	6.1
Norway	+ 0.9	+ 0.3 Q1	na	na	– 0.1 Jun*	– 1.1 Jun	3.6 Q2	3.3
Portugal	– 0.3	+ 2.2 Q1	na	na	+ 5.1 Jun*	+ 2.2 May	4.2 Q1	4.4

*Not seasonally adjusted. †New series. ‡Mar-May; claimant count rate 3.2% in Jun. §May-Jul.

Text refers only to the first 16 countries listed

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Prices and wages

Aug 23rd 2001
From The Economist print edition

% change at annual rate

	Consumer prices*			The Economist poll consumer prices forecast		Producer prices*			Wages/earnings		
	1 year		year ago	2001	2002	1 year		year ago	1 year		year ago
Australia	+ 6.0	Q2	+ 3.2	+ 3.9	+ 2.4	+ 5.6	Q2	+ 7.4	+ 3.7	Q2	+ 3.9
Austria	+ 2.8	Jun	+ 2.7	+ 2.5	+ 1.8	+ 1.9	Jul	+ 4.6	+ 2.7	Jun	+ 2.0
Belgium	+ 2.7	Jul	+ 2.8	+ 2.6	+ 2.0	+ 4.0	Jun	+ 8.7	+ 2.6	Q2	+ 2.2
Britain	+ 1.6	Jul	+ 3.3	+ 2.1	+ 2.4	+ 0.1	Jul	+ 2.7	+ 4.8	Jun	+ 4.1
Canada	+ 2.6	Jul	+ 3.0	+ 2.8	+ 2.1	+ 1.7	Jun	+ 5.7	+ 0.5	May	+ 3.2
Denmark	+ 2.4	Jul	+ 3.1	+ 2.4	+ 2.1	+ 2.7	Jul	+ 5.8	+ 3.8	Q1	+ 3.6
France	+ 2.1	Jul	+ 1.7	+ 1.8	+ 1.5	+ 2.3	Jun	+ 6.0	+ 4.3	Q1	+ 5.2
Germany	+ 2.6	Jul	+ 1.9	+ 2.7	+ 1.7	+ 2.2	Jul	+ 5.5	+ 1.8	Jun*	+ 2.1
Italy	+ 2.9	Jul	+ 2.6	+ 2.8	+ 2.0	+ 2.3	Jun	+ 6.9	+ 2.7	Jun*	+ 1.8
Japan	− 0.5	Jun	− 0.7	− 0.4	− 0.4	+ 0.8	Jul	− 0.4	+ 0.9	Jun	+ 2.8
Netherlands	+ 4.6	Jul	+ 2.8	+ 4.6	+ 2.7	+ 4.3	Jun	+ 8.8	+ 4.3	Jun	+ 3.2
Spain	+ 3.9	Jul	+ 3.6	+ 3.7	+ 2.8	+ 2.4	Jun	+ 5.8	+ 2.2	Q4	+ 2.4
Sweden	+ 2.9	Jul	+ 1.2	+ 2.3	+ 1.8	+ 2.2	Jun	+ 3.7	+ 2.7	May*	+ 1.9
Switzerland	+ 1.4	Jul	+ 1.9	+ 1.3	+ 1.3	+ 0.2	Jul	+ 2.7	+ 1.3	2000	+ 0.3
United States	+ 2.7	Jul	+ 3.7	+ 3.2	+ 2.2	+ 1.5	Jul	+ 4.3	+ 4.4	Jul	+ 3.6
Euro area	+ 2.8	Jul	+ 2.3	+ 2.8	+ 1.9	+ 3.3	Jun	+ 5.6	+ 2.6	Q1	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 2.5	Jul	+ 3.7	na	na	+ 0.7	Jul	+ 8.0	+ 4.8	Q2*	+ 4.6
Greece	+ 3.9	Jun	+ 2.5	na	na	+ 5.1	Apr	+ 7.0	na		na
Iceland	+ 7.9	Aug	+ 4.7	na	na	+ 6.9	Aug	+ 3.5	+ 8.1	Jul	+ 7.9
Ireland	+ 4.8	Jul	+ 6.2	na	na	+ 3.0	Jun	+ 5.5	+ 6.4	Q4*	+ 7.3
Luxembourg	+ 3.0	Jul	+ 3.4	na	na	+ 1.1	May	+ 5.5	+ 2.4	May*	+ 8.4
New Zealand	+ 3.2	Q2	+ 2.0	na	na	+ 7.8	Q1	+ 4.9	+ 1.8	Q2	+ 1.7
Norway	+ 2.7	Jul	+ 3.3	na	na	− 3.1	Jul	+ 6.4	+ 4.4	Q1*	+ 4.1
Portugal	+ 4.3	Jul	+ 3.2	na	na	+ 4.2	Jun	+16.2	+ 2.4	Apr*	na

*Not seasonally adjusted.

Text refers only to the first 16 countries listed

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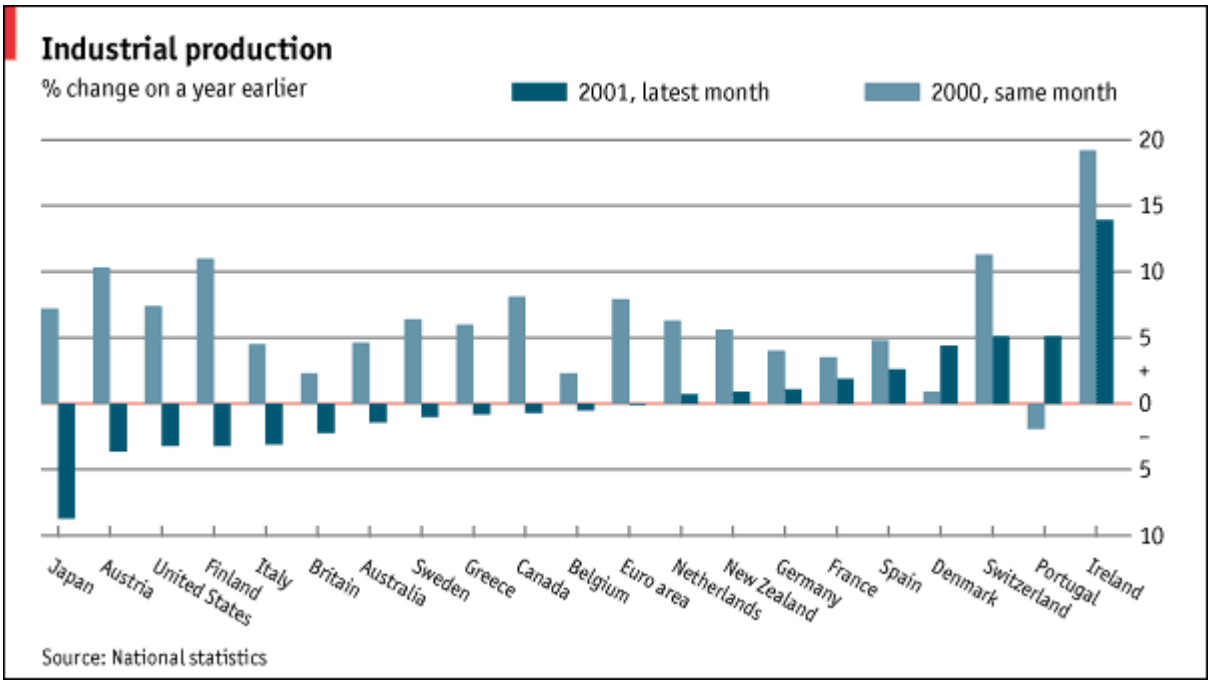
Industrial production

Aug 23rd 2001
From The Economist print edition

Over the past year, no fewer than 11 of the 20 countries in our chart, plus the euro area, have seen falls in industrial production. In only two countries, Denmark and Portugal, has the rate of growth in output risen. Remarkably, Irish industrial output increased by 13.9%. The worst reversal in fortune has been in Japan: production has slid by 8.7% in the past 12 months, after rising by 7.2% the year previously.



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Money and interest rates

Aug 23rd 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Aug 22nd 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+15.8	+ 7.0	Jun	4.95	6.53	4.95	5.67	6.24	7.14
Britain	+ 7.1	+ 7.6	Jul	4.94	6.11	5.03	4.87	5.28	6.10
Canada	+10.5	+ 6.6	Jun	3.93	5.62	4.42	5.49	5.74	7.09
Denmark	+ 3.4	– 5.5	Jun	4.74	5.70	4.45	5.04	5.55	7.05
Japan	+ 8.7	+ 3.3	Jul	0.03	0.30	0.05	1.33	1.83	1.48
Sweden	+ 6.5	+ 2.2	Jul	4.29	3.92	4.49	5.07	5.23	5.30
Switzerland	+ 0.3	+ 3.0	Jul	3.19	3.48	3.35	3.24	3.86	3.98
United States	+ 3.0	+11.5	Jul	3.56	6.50	3.73	4.98	5.87	6.81
Euro area†	+ 4.2	+ 6.3	Jun	4.31	5.04	3.98	4.77	5.15	5.36

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.43%, Japan No.234 1.37%. Central bank rates: US fed funds 3.50%, ECB refinancing 4.50%, BOJ overnight call 0.01%, BOE repo 5.00%.
Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Aug 23rd 2001
From The Economist print edition

1995=100

	Aug 14th	Aug 21st*	% change on one month	% change on one year
Dollar index				
All items	68.8	68.4	– 1.5	– 4.1
Food	70.2	69.5	– 1.6	+ 0.9
Industrials				
All	66.9	66.9	– 1.4	–10.3
Nfa†	68.7	67.0	nil	– 1.0
Metals	65.4	66.8	– 2.6	–17.0
Sterling index				
All items	76.4	74.5	– 3.4	– 1.7
Euro index				
All items	100.9	98.6	– 5.6	– 5.6
Yen index				
All items	89.2	87.2	– 4.9	+ 6.0
Gold				
$ per oz	274.50	276.55	+ 2.9	+ 1.0
West Texas Intermediate				
$ per barrel	28.08	28.20	+ 8.0	–11.9

* Provisional. † Non-food agriculturals.

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Stockmarkets

Aug 23rd 2001
From The Economist print edition

Market indices

	Aug 22nd	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,255.1	3,425.2	3,094.3	– 1.6	– 5.0	+ 3.2	– 0.3
Austria (ATX)	1,205.7	1,245.8	1,052.2	– 1.0	–30.6	+12.3	+10.2
Belgium (Bel 20)	2,848.6	3,030.4	2,591.6	– 1.2	–22.6	– 5.8	– 7.6
Britain (FTSE 100)	5,408.7	6,334.5	5,275.7	– 1.0	–22.0	–13.1	–15.3
Canada (Toronto Composite)	7,538.6	9,348.4	7,415.5	+ 0.1	–33.8	–15.6	–18.0
Denmark (KBX)	246.3	294.3	234.7	– 1.5	–18.4	– 7.0	– 8.6
France (SBF 250)	3,104.4	3,820.2	3,084.7	– 2.3	–29.3	–17.7	–19.3
(CAC 40)	4,812.1	5,998.5	4,773.2	– 2.5	–30.5	–18.8	–20.4
Germany (Xetra DAX)	5,220.2	6,795.1	5,207.8	– 4.3	–35.3	–18.9	–20.4
Italy (BCI)	1,555.3	1,948.4	1,540.9	– 2.2	–28.7	–18.8	–20.4
Japan (Nikkei 225)	11,396.4	14,529.4	11,254.7	– 3.1	–70.7	–17.3	–21.2
(Topix)	1,165.5	1,441.0	1,155.2	– 2.4	–59.6	– 9.2	–13.4
Netherlands (AEX)	526.4	642.3	518.3	– 1.2	–25.0	–17.4	–19.0
Spain (Madrid SE)	811.5	963.9	798.6	– 1.5	–29.2	– 7.9	– 9.6
Sweden (Affarsvarlden Gen)	220.3	293.1	214.8	– 1.8	–45.0	–20.7	–27.0
Switzerland (Swiss Market)	6,662.9	8,135.4	6,574.0	– 1.6	–20.8	–18.1	–19.6
United States (DJIA)	10,276.9	11,337.9	9,389.5	– 0.7	–12.3	– 4.7	– 4.7
(S&P 500)	1,165.3	1,373.7	1,103.3	– 1.1	–23.7	–11.7	–11.7
(Nasdaq Comp)	1,860.0	2,859.2	1,638.8	– 3.1	–63.2	–24.7	–24.7
Europe (FTSE Eurotop 300)*	1,274.5	1,545.5	1,262.6	– 1.8	–25.2	–16.9	–18.5
Euro area (FTSE Ebloc 100)*	1,125.5	1,404.1	1,117.0	– 2.5	–27.4	–19.2	–20.7
World (MSCI)†	1,044.6	1,249.2	1,014.6	– 0.2	–27.9	na	–14.5
World bond market (Salomon)‡	451.0	447.8	420.6	+ 0.6	– 1.9	na	+ 1.6

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Aug 23rd 2001
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Aug 22nd	Exchange rate trade-weighted† year ago	Currency units per $ Aug 22nd	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2001‡
Australia	− 0.1 Jun	− 12.9 Q1	− 2.9	− 3.1	73.6	76.2	1.86	1.75	2.71	1.72	1.56	0.1
Austria	− 5.6 Apr	− 4.3 Jun	− 2.3	− 2.2	100.6	99.4	14.9	15.4	21.7	13.8	12.5	-0.6
Belgium	+ 10.6 Jun	+ 11.2 Mar	+ 4.3	+ 4.5	99.5	98.0	43.8	45.1	63.8	40.3	36.6	0.7
Britain	− 44.9 Jun	− 19.2 Q1	− 1.8	− 2.1	104.7	107.5	0.69	0.68	–	0.63	0.57	1.2
Canada	+ 47.4 May	+ 22.2 Q1	+ 3.1	+ 2.4	77.5	80.1	1.54	1.49	2.25	1.42	1.29	2.6
Denmark	+ 47.4 Jun	+ 4.5 Jun	+ 1.4	+ 1.4	102.9	99.8	8.09	8.34	11.8	7.45	6.75	2.9
France	nil Jun	+ 14.3 Jun	+ 1.6	+ 1.6	102.2	100.6	7.12	7.34	10.4	6.56	5.95	-0.5
Germany	+ 57.2 Jun	− 21.8 Jun	− 1.0	− 0.8	99.2	97.1	2.12	2.19	3.09	1.96	1.77	-1.7
Italy	+ 3.3 May	− 4.9 May	− 0.3	− 0.2	72.9	71.8	2,103	2,166	3,061	1,936	1,756	-1.3
Japan	+ 90.4 Jun	+ 96.3 Jun	+ 2.2	+ 2.1	139.1	156.7	120	107	174	110	–	-6.3
Netherlands	+ 18.9 Jun	+ 13.7 Q2	+ 3.9	+ 3.9	98.4	96.7	2.39	2.47	3.48	2.20	2.00	1.3
Spain	− 38.2 May	− 15.9 Apr	− 2.8	− 2.3	74.5	73.5	181	186	263	166	151	nil
Sweden	+ 12.8 Jun	+ 5.6 Jun	+ 2.1	+ 2.3	74.6	82.8	10.25	9.34	14.9	9.44	8.56	3.6
Switzerland	+ 0.3 Jul	+ 28.3 Q1	+11.0	+10.8	109.1	105.0	1.65	1.73	2.40	1.52	1.38	na
United States	−453.5 Jun	−449.3 Q1	− 4.1	− 4.0	116.6	112.4	–	–	1.46	0.92	0.83	2.1
Euro area	− 1.2 May	− 30.6 May	− 0.2	− 0.1	80.1	77.1	1.09	1.12	1.58	–	0.91	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 14.1 Jun	+ 9.3 Jun	na	na	78.9	76.1	6.46	6.65	9.40	5.95	5.39	5.3
Greece	− 7.5 Jan	− 7.7 Jan	na	na	57.7	57.4	370	377	539	341	309	nil
Iceland	− 0.4 Jun	− 0.9 Q1	na	na	na	na	98	80.6	143	90.2	81.8	2.4
Ireland	+ 28.3 May	− 1.3 Q1	na	na	88.3	85.8	0.86	0.88	1.24	0.79	0.71	4.5
Luxembourg	− 2.5 May	+ 1.2 Q1	na	na	99.5	98.0	43.8	45.1	63.8	40.3	36.6	3.6
New Zealand	nil Jun	− 2.3 Q1	na	na	82.9	76.7	2.25	2.33	3.28	2.07	1.88	1.0
Norway	+ 28.0 Jul	+ 25.6 May	na	na	95.2	92.3	8.82	9.02	12.8	8.12	7.36	15.3
Portugal	− 13.7 May	− 9.2 Jun	na	na	89.8	88.4	218	224	317	200	182	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

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Exchange-rate forecasts

Aug 23rd 2001
From The Economist print edition

Exchange-rate forecasts

from J.P. Morgan Chase
Currency units per $

	Aug 22nd	3-month	12-month
Euro area*	0.92	0.91	0.88
Japan	120	127	122
Australia	1.86	1.86	1.82
Britain†	1.46	1.44	1.38
Canada	1.54	1.50	1.50
Denmark	8.09	8.20	8.49
Sweden	10.25	9.95	9.87
Switzerland	1.65	1.70	1.78
China	8.28	8.28	8.25
Singapore	1.75	1.82	1.77
South Korea	1278	1333	1287
Brazil	2.53	2.42	2.56
Mexico	9.12	9.57	9.93
Poland	4.27	4.06	4.18
Russia	29.4	30.5	32.3
South Africa	8.37	8.00	8.38

*$ per € †$ per £

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Overview

Aug 23rd 2001
From The Economist print edition

Argentina managed to secure an additional $8 billion loan from the IMF, helping to calm investors' fears of a possible debt default. Financial markets jumped on the news, and the interbank lending rate plunged from 32% to 14%. But questions remain as to whether the money will be enough.

South Korea's economy continued to look weak in the second quarter. GDP grew by only 0.5% over the first quarter, and by 2.7% over a year earlier. Only a year ago, the economy was growing at a 9.7% rate. Compared with some other East Asian economies, however, South Korea is holding up well. In the second quarter, **Taiwan's** GDP fell by 2.4% over a year earlier, led by a precipitous decline in exports. Industrial production in Taiwan fell by 10.4% over the year to July.

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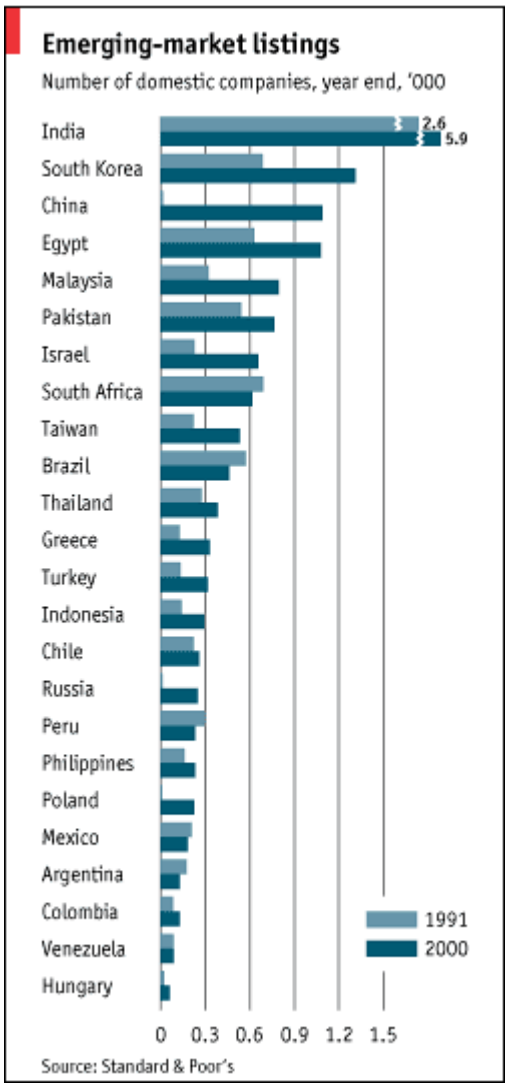
Emerging-market listings

Aug 23rd 2001
From The Economist print edition

China and the ex-communist countries saw huge increases in the number of domestic companies listed on their stock exchanges during the 1990s, according to data collected by Standard & Poor's. By contrast, the number of listed companies fell in most of the Latin American economies, as increased foreign competition and overvalued currencies took their toll on uncompetitive firms.



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Economy

Aug 23rd 2001
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.8	Q2	+ 8.1	Jul	+ 1.5	Jul	+19.9	Jul	+20.5	2000	182.0	May
Hong Kong	+ 2.5	Q1	– 0.1	Q1	– 0.9	Jul	–12.1	Jun	+ 8.8	Q1	114.6	Jul
India	+ 5.7	Q3	+ 1.5	Jun	+ 3.4	Jun	– 5.3	Jun	– 2.3	Q1	40.9	Jul
Indonesia	+ 3.5	Q2	+ 4.5	Q4	+13.0	Jul	+24.8	Jun	+ 6.3	Q1	27.9	Jun
Malaysia	+ 3.2	Q1	– 9.9	Jun	+ 1.4	Jul	+15.3	Jun	+ 8.4	Q4	25.6	Jun
Philippines	+ 2.5	Q1	+ 2.0	May	+ 6.8	Jul	+ 5.1	Jun	+ 8.5	Apr	12.5	May
Singapore	– 0.9	Q2	–16.1	Jun	+ 1.2	Jun	+ 4.6	Jul	+22.6	Q2	76.0	May
South Korea	+ 2.7	Q2	– 2.7	Jun	+ 5.0	Jul	+14.0	Jul	+13.8	Jun	94.3	Jun
Taiwan	– 2.4	Q2	–10.4	Jul	+ 0.1	Jul	+12.6	Jul	+14.1	Q2	109.1	Jun
Thailand	+ 1.8	Q1	+ 1.7	Jun	+ 2.2	Jul	+ 3.1	Jun	+ 6.9	Jun	31.0	Jun
Argentina	– 2.1	Q1	+ 0.2	Jul	– 1.0	Jul	+ 2.3	Jun	– 9.0	Q1	21.1	Jun
Brazil	+ 0.8	Q2	– 1.4	Jun	+ 7.8	Jul	– 1.6	Jul	–26.8	Jun	37.3	Jun
Chile	+ 3.5	Q2	+ 6.3	Jun	+ 3.2	Jul	+ 1.5	Jul	– 1.4	Q1	14.3	Jun
Colombia	+ 1.7	Q1	– 2.6	Jun	+ 8.1	Jul	+ 1.5	May	– 0.7	Q1	9.5	Jul
Mexico	nil	Q2	– 3.9	Jun	+ 5.9	Jul	– 9.5	Jun	–17.8	Q1	40.8	Jun
Peru	– 2.3	Jun	+ 1.3	May	+ 2.2	Jul	– 0.2	Jun	– 1.7	Q1	8.3	May
Venezuela	+ 3.5	Q1	na		+13.0	Jul	+17.2	Q1‡	+12.5	Q1	10.5	Jun
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.2	May	– 9.9	Q1	– 0.2	Q1	13.0	Apr
Israel	+ 1.4	Q2	– 6.3	May	+ 0.4	Jul	– 7.3	Jul	– 1.1	Q1	23.9	Jul
South Africa	+ 2.7	Q1	+ 3.1	Jun	+ 5.3	Jul	+ 4.1	Jun	+ 0.1	Q1	6.1	Jun
Turkey	– 1.9	Q1	–10.4	Jun	+56.3	Jul	–22.8	May	– 5.4	May	16.6	Jun
Czech Republic	+ 3.8	Q1	+ 3.7	Jun	+ 5.9	Jul	– 3.5	Jul	– 2.7	Q1	12.9	Jul
Hungary	+ 4.4	Q1	– 0.4	Jun	+ 9.4	Jul	– 2.4	Jun	– 1.7	Jun	11.9	Jul
Poland	+ 2.3	Q1	+ 1.1	Jul	+ 5.2	Jul	–10.1	Jun	– 7.2	Jun	27.0	Jul
Russia	+ 4.9	Q1	+ 2.9	Jul	+22.2	Jul	+59.5	Jun	+45.9	Q1	31.3	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 5.6	2000†	+26.6	Mar	+ 3.6	May	– 1.5	Jul	– 1.1	2000†	1.3	May
Saudi Arabia	+ 4.5	2000§	na		– 0.2	May	+50.9	2000	+15.6	2000	17.1	Jun

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; EIU; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Aug 23rd 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Aug 22nd		Dec 31st 2000	
	Aug 22nd	year ago	Aug 22nd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.0	na	1,988.7	−2.3	−9.3	−9.3
Hong Kong	7.80	7.80	11.4	3.36	11,188.6	−7.8	−25.9	−25.9
India	47.1	45.8	68.6	6.88	3,297.4	−1.0	−17.0	−17.7
Indonesia	8,615	8,395	12,540	17.66	442.0	+1.3	+6.2	+19.2
Malaysia	3.80	3.80	5.53	3.30	657.1	+0.1	−3.3	−3.3
Philippines	51.0	44.9	74.2	11.25	1,294.4	−2.3	−13.4	−15.0
Singapore	1.75	1.72	2.55	2.38	1,632.4	−0.7	−15.3	−16.2
South Korea	1,278	1,115	1,860	4.83	574.9	−0.4	+13.9	+12.8
Taiwan	34.6	31.0	50.3	3.65	4,487.5	−2.9	−5.4	−9.5
Thailand	44.6	40.7	64.9	3.13	321.3	+1.1	+19.4	+16.1
Argentina	1.00	1.00	1.45	31.69	328.4	+0.5	−21.2	−21.3
Brazil	2.53	1.82	3.68	19.04	12,952.2	−5.3	−17.0	−35.9
Chile	669	545	973	4.47*	5,688.0	nil	+16.8	+0.2
Colombia	2,283	2,198	3,323	12.45	983.6	−0.7	na	na
Mexico	9.12	9.27	13.3	6.97	6,333.1	−3.2	+12.0	+18.0
Peru	3.49	3.47	5.1	5.45	1,346.7	−0.6	+11.4	+12.6
Venezuela	730	690	1,063	14.65	6,847.5	−1.5	+0.8	−3.4
Egypt	4.26	3.50	6.19	9.00	5,579.2	−2.0	−27.2	−33.4
Israel	4.24	4.04	6.17	4.42	425.3	−1.5	−14.0	−17.9
South Africa	8.38	6.97	12.2	9.60	8,808.2	+1.7	+5.8	−4.4
Turkey	1,457,500	651,355	2,121,537	65.00	9,626.0	+4.2	+2.0	−53.1
Czech Republic	37.3	39.5	54.3	5.51	368.4	−1.9	−23.0	−22.4
Hungary	279	292	406	10.30	6,357.2	−2.1	−19.0	−17.9
Poland	4.27	4.36	6.21	15.37	12,477.3	−0.2	−30.1	−32.3
Russia	29.4	27.7	42.8	25.00	199.9†	+3.1	+43.1	+39.5
EMF (MSCI)‡	1.00	1.00	1.46	na	298.6	−2.3	na	−10.6
EMBI+§	1.00	1.00	1.46	na	207.0	+0.5	na	+2.5

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; EIU; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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